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The Contracting State

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JODY FREEMAN*

I. INTRODUCTION .................................................................................................... 155
II. PRIVATIZATION .................................................................................................... 160
III. GOVERNMENT-PRIVATE CONTRACTS ................................................................. 164
   A. Objections to Contracting Out ........................................................................ 169
      1. Consequentialist Concerns ........................................................................ 169
      2. “Technocratic” Concerns ........................................................................... 170
      3. Ethical Concerns ......................................................................................... 172
      4. Administrative Law Concerns .................................................................... 174
         a. Examples .................................................................................................. 176
            i. Nursing Homes ...................................................................................... 177
            ii. Medicaid and Managed Care .............................................................. 180
            iii. Private Prisons .................................................................................... 185
IV. REGULATORY CONTRACTS .................................................................................. 189
   A. Regulation as Negotiation .............................................................................. 189
   B. Experiments in “Contractual” Regulation ...................................................... 191
   C. Objections to Regulatory Contracts ............................................................... 198
      1. The “Undemocratic” Critique ...................................................................... 198
      2. Ousting Public Law Norms ....................................................................... 199
V. CONTRACT AS AN ACCOUNTABILITY MECHANISM ............................................. 201
VI. THE UNCOMFORTABLE INTERFACE OF PUBLIC LAW NORMS AND PRIVATE LAW PRINCIPLES ........................................................... 207
VII. CONCLUSION ...................................................................................................... 212

I. INTRODUCTION

The modern administrative state might aptly be dubbed “the contracting state.” Around the world, governments appear to be both shrinking and outsourcing many of their traditional functions to private parties, sometimes indirectly by devolving power to local governments that themselves depend heavily on private actors. 1 In the United States, federal, state, and local governments now routinely employ contracts with private providers to furnish services, deliver benefits, and perform significant (and sometimes traditionally “public”) functions. 2 Less visibly, a number of federal agencies have begun

* Professor of Law, University of California Los Angeles. I am grateful to Ann Carlson, Michael Asimow, Sharon Dolovich, Dan Guttman, Gillian Lester, Jim Rossi, J.B. Ruhl, Jim Salzman, Mark Seidenfeld and the participants in this symposium for helpful comments on earlier drafts. The article benefited as well from a workshop at the Washington College of Law at American University. Thanks to Joanna Wolfe for excellent research assistance. Jason Kellogg deserves credit for enormous editorial patience. Errors and omissions are mine.


2. Public sector reform in Britain has resulted in significant government downsizing and contracting out. See KIERON WALSH, PUBLIC SERVICES AND MARKET MECHANISMS at xi (1995); see also Murray Hunt, Constitutionalism and the Contractualisation of Government in the United Kingdom, in THE PROVINCE OF ADMINISTRATIVE LAW 21 (Michael Taggart
experimenting with contractual approaches to regulation as well, sometimes pursuant to statutory mandates, and other times as part of agency enforcement discretion. Governments increasingly act in all of their capacities, it seems, via contractual devices.

Despite the rising prominence of contract as an administrative and regulatory instrument, its implications for administrative law are not well understood. In this Article, I begin a much-needed discussion of contractual governance by focusing on two species of contract—contracts to provide services or benefits (already well-entrenched in the United States) and regulatory contracts (a nascent, but noteworthy, development). I explain the practical and the theoretical problems these contracts pose, chief among which is their potential to undermine accountability in decisionmaking.

Widespread contracting out of services or arguably “public” functions could have dire consequences under some circumstances—if legislatures systematically outsource their traditional functions and use contracts with private parties to insulate decisions from constitutional scrutiny, for example. Contracting could obscure traditional lines of accountability, enabling legislatures to take credit for doing little, while blaming private contractors for program failures.

Moreover, even with the best intentions, legislatures and their agency delegates may lack the capacity to oversee compliance with contractual terms. Absent a procedural right to participate in contract negotiations, and without third-party rights of action, the beneficiaries of these contracts may be left with no avenues for participation or redress. As a result, the pressure for government-private contracts to absorb public law norms of fairness, rationality, and accountability will only intensify if government increasingly employs them to provide important services and outsource its traditional functions. More broadly, widespread contracting out could wreak havoc with the balance of power among the branches of government: weakening the legislative and executive branches through fragment-

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4. See id. at 548.
5. Some commentators believe that this already describes a good deal of governance. See, e.g., JOEL F. HANDLER, DOWN FROM BUREAUCRACY (1996).
tation and delegation, and overburdening the judiciary with challenges to contractual schemes.  

6. Contractual regulatory instruments raise different, but equally serious concerns. The possibility that governments might negotiate regulatory standards with the entities they are empowered to regulate strikes most traditional administrative law scholars as anathema—a recipe for either corporatism or capture. Treating regulations as enforceable contracts could require governments to unilaterally absorb the costs of changing conditions, or bind governments to the bad bargains of their predecessors, a possibility that no longer seems remote in light of recent Supreme Court jurisprudence.  

7. Some commentators might think that regulatory contracts are insufficiently similar to the phenomenon of contracting out to merit inclusion in a larger category of contractual instruments of governance. In this view, contractual regulatory instruments emerge for distinct reasons and cause different problems than widespread contracting out. Indeed, administrative law scholars tend to treat contractual regulatory instruments as mere instances of agency discretion: optional implementation tools designed to achieve the agency’s ultimate goal. If the regulatory goal is lawful, and the agency’s exercise of discretion remains within permissible bounds, then the use of contract (as opposed to any other tool) as a method of implementation seems unobjectionable. Seen in this light, contractual regulatory tools raise familiar problems best solved by familiar measures. The legislature might bar the use of contract through constraints on agency discretion or specifically authorize the agency to use contract as an implementation option. Either way, the issue is discretion; contract is decidedly secondary. Not all instances of discretion are alike, however, and the full implications of these tools might best be glimpsed through the prism of

6. See David Mullan, Administrative Law at the Margins, in The Province of Administrative Law, supra note 2, at 155-56 (arguing that judicial review may intensify in response to privatization).  


8. I thank Mark Niles and Jim Salzman for raising this objection to the inclusion of regulatory contracts. They point out that the trend toward contracting out may have emerged for different reasons than the trend toward using contract to implement regulation, and they argue that this distinction ought to make a difference. Indeed, contracting out may be a response to tightening government budgets, a generalized public antipathy toward government, and the increasing ideological appeal of the market, whereas the emergence of regulatory contracts might be explained by the need for greater flexibility in executing regulatory responsibilities. To put a fine point on it, resorting to contractual regulatory approaches might be nothing more than a few agencies’ defensive reaction to a Republican Congress that disfavors environmental and health and safety regulation. Even if this is true, however, the contractual nature of these innovations—and their emergence at a time when other contractual approaches are also becoming widespread—bears noting, and has some important implications for administrative law.
contract. Regulatory contracts pose unique problems for administrative law. Among other things, they depend heavily on private actors that tend not to be bound by constitutional or administrative law constraints. Unlike the agency discretion perspective, the contractual lens brings this dependence on private actors, and its attendant risks, into focus. It also highlights the potential conflict between the government’s role as authoritative regulator and its role as contracting partner, which even explicit legislative authorization cannot resolve. Finally, the contractual prism foregrounds the ways in which contract, as a particular mode of decisionmaking, might uniquely obstruct or facilitate public participation.

Thus, the conceptualization of seemingly different types of contracts as a family of related tools is meant to supplement, rather than displace, other useful perspectives. It treats contractual regulatory tools not merely as potentially problematic instances of discretion, but as part of an emerging “contract culture”—a trend toward fragmented and decentralized governance that includes, but is not limited to, contracting out government functions. Among other things, that trend may impose great pressure on courts to reconcile principles of private contract law, which do not necessarily afford agencies deference, with principles of administrative law, which do.

At the same time, despite their significant risks, government-private contracts of all types might nonetheless produce important benefits that we should not overlook. The rise of contract may signal not so much the retreat of the state as a reconfiguration of the state’s role in governance. That reconfiguration could conceivably amount to a net gain in accountability, or at least not a net loss. In an era of greater private involvement in every facet of administration and regulation, contracts can themselves function as potentially crucial accountability mechanisms. For example, contractual provisions may allow third-party beneficiaries to hold the contracting parties to


10. See WALSH, supra note 2, at 136-37 (referring to the emergence of a contract culture); see also DONAHUE, supra note 2, at 6-8. See generally GENERAL ACCOUNTING OFFICE, GAO/HEHS-98-6, SOCIAL SERVICE PRIVATIZATION: EXPANSION POSES CHALLENGES IN ENSURING ACCOUNTABILITY FOR PROGRAM RESULTS (1997) (documenting expanded privatization of social services and analyzing implications for accountability), available at http://www.access.gpo.gov/su_docs/aces/aces160.shtml.

11. Although private parties have always shared responsibility for governance to greater or lesser degrees, their roles have diversified and expanded, sometimes into territory once regarded as the exclusive province of the state. See generally Freeman, supra note 3. In light of this expansion of private authority, some scholars have argued that there is no longer a justification for treating public and private power differently: that we ought to constrain the private exercise of discretion just as we do public agencies. See id. at 574-75.
their commitments. Contracts could also enable government agencies to accomplish indirectly what, for legal or political reasons, they cannot achieve directly. As with grants-in-aid between the federal and state governments, public-private contracts could be a means of extending government priorities and policies to private actors, and of exacting concessions and gains that might otherwise be beyond the government’s regulatory reach.

Like settlements, regulatory contracts could provide the parties more flexibility than does the formal enforcement process. This flexibility accrues of course not only to the private contracting party, but to government as well. Through regulatory contract, private actors may agree to conform to substantive regulatory requirements or adopt procedural norms that are otherwise inapplicable to them or unenforceable against them. In addition, regulatory contracts might function as disclosure mechanisms that identify and specify regulatory goals, which might in turn enable both government overseers and third-party auditors to monitor progress toward those goals. Under the right circumstances then, regulatory contracts could prove at least no less effective and democratic than other regulatory instruments.

Whether one welcomes or fears the rise of contract as an administrative and regulatory tool, however, existing doctrines and theoretical frameworks will need to adapt to its emergence. Contractual instruments pose a host of doctrinal and theoretical problems for which administrative law provides no ready answers. Administrative law theory has yet to explore, let alone internalize, such a contractual model of governance. Each of the competing theories of the field—public interest, pluralist, civic republican, and public choice—consists at its core of a distinctive understanding of the agency’s function and a unique justification for judicial review, but they


13. See id. at 1760-61 (noting the emergence of public participation in agency decisionmaking as a way to improve decisions and increase public participation in the process).


15. See, e.g., Mathew D. McCubbins et al., Administrative Procedures as Instruments of Political Control, 3 J.L. ECON. & ORG. 243 (1987) (noting that in the absence of oversight, agency officials are likely to make decisions reflecting personal preferences derived from private political values, personal career objectives, and aversion to effort).

16. They are, respectively, an institution devoted to implementing legislation in the public interest, see Freeman, supra note 3, at 558-59; a broker of stakeholder interests, see id. at 559-60; an expert body deliberating in a public-regarding way, see id. at 559; or an agent of self-interested legislators, see id. at 561-63.
share a hierarchical vision of governance. A conception of the government agency as “contracting partner” fits comfortably with none of these accounts. As a result, the complement of oversight mechanisms currently envisioned by these theories to constrain agency action might be inadequate—or wholly inappropriate—for the problems that arise in the contracting state.

In Part II of this Article, I describe how privatization trends in the United States have created an environment in which public-private contracts are likely to flourish. The bulk of the Article is devoted to the two species of such contracts that appear to pose the most difficulty for administrative law—contracts for social services and regulatory contracts. In Parts III and IV, I provide examples of contracts for social services and regulatory contracts, respectively, and discuss the most frequent objections to them. I argue in Part V that despite the risks they pose, both kinds of contracts offer some attractive benefits, and I explore in particular their potential to function as accountability mechanisms. I conclude by describing how these arrangements could create an uncomfortable confrontation between public law principles of deference to agency action and private law principles of contract interpretation.

II. PRIVATIZATION

The rise of contract as an administrative and regulatory instrument in the United States has occurred in the context of a global privatization movement in which governments around the world have privatized state industries and undergone significant public sector reform. Over the last twenty years, following the Thatcher government’s lead in Great Britain, numerous liberal democracies such as New Zealand, Australia, and Canada have adopted aggressive reforms aimed at developing markets for the provision of most social services, including education, health care, job training, housing, municipal services, and the like. The privatization of state industries

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17. With the possible exception of public choice theory, which is arguably more explanatory than normative. It is not difficult to imagine normative proposals that might flow from the public choice account, however. For more on public choice theory’s impact on administrative law, see Freeman, supra note 3.

18. While somewhat helpful as a starting point, the law governing traditional government procurement of goods and services addresses only a narrow subset of government contracts. The procurement framework is either imperfect or wholly unsuitable for responding to the more widespread use of contract to deliver services or perform arguably public functions. At the same time, the law governing the interpretation and enforcement of regulatory contracts remains in flux. See United States v. Winstar Corp., 518 U.S. 839 (1996).

19. See DONAHUE, supra note 2, at 6-7.

20. See WALSH, supra note 2, at 26 (describing the five major mechanisms that make up public sector reform: user charges for services, opening services to competitive tende-
together with the shift to internal markets, competitive tendering, and contracting out has created new relationships between public and private actors in these countries and forced governments to devise measures for structuring and monitoring the new arrangements. 21 Kieron Walsh describes the result as a form of organization that is "neither market nor hierarchy, but which lies rather uncomfortably between the two." 22 These trends might be described as a shift from hierarchical relationships to contractual ones. 23

In the United States, the privatization movement has primarily taken the form of increased contracting out of government services, devolution, and streamlining government. 24 These three developments have occurred simultaneously, and they have been mutually reinforcing. Although privatization has developed into an ideological movement in the United States only in the last twenty years, relying on the private sector to perform "public" functions as a practical matter has a long history. 25

Since at least the post-war period, the federal government, along with state and local governments, has increasingly depended on private contractors to provide a wide variety of goods and services not only for government consumption but for public consumption as well, from weapons systems to environmental impact statements to social services, including health care, welfare, day care, job training, infrastructure maintenance, and waste collection. 26 The trend toward privatizing social services has accelerated and intensified in the last two decades, however, as a result of a concerted effort by the federal government (beginning with the Reagan Administration) to devolve power to lower levels of government and spur the private provision of

21. In the United Kingdom and elsewhere, the state engages in three primary modes of contracting: internal contracting, competitive tendering, and the contracting out of services. See id. at 121.
22. Id. at xviii.
23. See id. (observing that "[a]uthority relations are being redefined as contracts" and that "[t]he public service is becoming a more or less integrated network of organisations that relate through contract and price rather than authority").
24. See DONAHUE, supra note 2, at 6-8.
26. See id. at 5-6, 42-43. Until recently, contracts for health, welfare, and similar social services primarily went to nonprofits. See id. at 5. This has begun to change, however, as economic conditions make social welfare delivery increasingly attractive to for-profit firms. See id. at 10. For-profit participation has been on the rise in recent years. For-profit nursing homes increased 140% between 1960 and 1976. See Eleanor D. Kinney, Private Accreditation as a Substitute for Direct Government Regulation in Public Health Insurance Programs: When Is It Appropriate?, LAW & CONTEMP. PROBS., Autumn 1994, at 47, 51. By 1980, more than 90% of nursing homes were privately owned. See Patricia A. Butler, Assuring the Quality of Care and Life in Nursing Homes: The Dilemma of Enforcement, 57 N.C. L. REV. 1317, 1337 n.96 (1979).
publicly financed services. 27 Notably, during this period the percentage of for-profit organizations involved in service delivery has expanded and the universe of functions thought suitable for privatization appears to have enlarged. 28 Both the federal and state governments have turned to for-profit firms to run detention centers and prisons for example, a function once thought to be the exclusive province of government.

The devolution of authority from federal to state and local governments has contributed to the rise of contracting out, as lower levels of government turn to private actors in order to help execute their new responsibilities. Welfare reform offers a recent example of this phenomenon. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 29 (PRA)—which abolished the federal entitlement to financial assistance known as Aid to Families with Dependent Children, providing instead a system of block grants to the states 30 —seems to be intensifying the privatization of benefits administration in at least some states. 31 Similarly, the devolutionary aspects of the Balanced Budget Act of 1997 32 appear to have accelerated state reliance on private organizations, including managed care organizations, to deliver care to the Medicaid population. 33

At the same time, recent efforts by the Clinton Administration to streamline government and promote “public-private partnerships” seem likely to foster greater reliance on private sector institutions. Vice President Gore’s high profile effort 34 “reinvent” government, adopted in the National Performance Review, cut the budgets of ex-

27. See SALAMON, supra note 25, at 6-8; John J. DiIulio, Jr. & Richard P. Nathan, Introduction to MEDICAID AND DEVOLUTION 1 (Frank J. Thompson & John J. DiIulio, Jr. eds., 1998) (referring to the 1990s as “the decade of devolution”).
30. See id. § 103(a), 110 Stat. at 2112-60 (codified as amended at 42 U.S.C. §§ 601-619 (Supp. V 1999)). The Act attaches relatively few conditions to the block grants and allows states to design benefit programs and eligibility requirements. See id.
33. In addition to increasing state flexibility to set payment levels, see id. §§ 4711-4715, 111 Stat. at 507-09 (codified as amended at 42 U.S.C. §§ 1396a to 1396r-7), the Act allows states to mandate enrollment in managed care programs without applying for federal waivers. See § 4702(a), 111 Stat. at 494-95 (codified as amended at 42 U.S.C. § 1396d(a), 1396d(t)). The waiver process had enabled rigorous federal oversight of state reliance on managed care organizations serving the Medicaid population. See MEDICAID AND DEVOLUTION, supra note 27, at 122. The authors argue that devolution is a complex, incremental process, and that it ought not to be defined as wholesale federal withdrawal from a policy field. See id. at 7. Enhanced state flexibility over the Medicaid program has coincided with the general shift from fee-for-service to managed care, and that shift has introduced new players (such as Managed Care Organizations) into the Medicaid regime. The combination of devolution and managed care has enhanced the already significant role that contract plays in securing compliance with Medicaid program requirements.
ecutive agencies across the board, streamlined bureaucracies through a variety of measures, and sought to promote regulatory innovation in the form of consensus-based decisionmaking and public-private partnerships. As both a rhetorical and a practical matter, these measures invite increased reliance on the private sector.

This combination of events—contracting out, devolution, and public sector reform—has created an environment in which public-private contract seems likely to flourish. And although commentators have debated the merits of privatization from an economic and political perspective and sought to identify the conditions under which privatization will produce efficiency gains, the implications of privatization for administrative law remain unclear. At first blush, contractual instruments might strike administrative law scholars as uninteresting or unproblematic. They do not appear to disrupt settled categories of agency action, challenge established explanations of the administrative process, or impugn traditional justifications for judicial review. However, government-private contracts have the poten-


36. See, e.g., Andrei Shleifer, State Versus Private Ownership, J. ECON. PERSP., Fall 1998, at 133, 141-44 (1998) (analyzing politics of government ownership and privatization and noting that political considerations not only strengthen the case for privatization, but in fact drive the decision to privatize); see also DONAHUE, supra note 2, at 11-12 (arguing that the values of efficiency and accountability of public and private arrangements in "organizational architecture" should be reorganized in a way that will best deliver public goods and services). Privatization does not guarantee accountability; however, in some cases, private ownership has reduced access to information that was more easily available under public ownership. See C. Graham & T. Prosser, "Rolling Back the Frontiers"? The Privatisation of State Enterprises, In A Reader On ADMINISTRATIVE LAW 63, 80-86 (D.J. Galligan ed., 1996); see also HANDLER, supra note 5, at 86-90 (discussing public-private contracts that lack competition and cause a decrease in efficiency and accountability).

37. See, e.g., DONAHUE, supra note 2, at 56-78.

38. Much administrative law scholarship consists of debates over statutory interpretation and standards of judicial review of agency action. See, e.g., Colin S. Diver, Statutory Interpretation in the Administrative State, 133 U. PA. L. REV. 549 (1985); Richard J. Pierce, Jr., Chevron and Its Aftermath: Judicial Review of Agency Interpretations of Statutory Provisions, 41 VAND. L. REV. 301 (1988). Another significant body of administrative law concerns itself with the advantages and disadvantages of legislative controls, both formal and
tial to do all three. In an era in which private actors play significant roles in every aspect of governance, contract is both a crucial administrative policy instrument and a potential source of accountability.

III. GOVERNMENT-PRIVATE CONTRACTS

Procurement contracts for goods and services are the most familiar form of government contracting and, ironically, the least problematic from an administrative law perspective. As a matter of course, all levels of government contract with private providers for goods and services, ranging from weapons systems to office supplies. The federal government has established an elaborate body of procurement law that governs such purchases. It consists of a highly detailed bidding, award, and contract management process. Of all the “contract-like” arrangements into which government enters, procurement contracts most closely resemble traditional commercial contracts. And yet, federal procurement requires contractors to follow strict, government-unique product specifications and contract rules and regulations. Indeed, despite their apparent similarity to com-informal. See, e.g., Stephen Breyer, The Legislative Veto After Chadha, 72 GEO. L.J. 785 (1984); see also Mathew D. McCubbins et al., supra note 15.

39. For examples, see Freeman, supra note 3, at 547. See also SALAMON, supra note 25, at 42 (describing the phenomenon of “third-party government,” in which government depends on a host of third-party institutions to carry out its missions). Administrative law theory has largely ignored the private role in governance, focusing instead on the relationships among legislatures, agencies, and courts. For an explanation of the roots of agency-centered analysis, see Jody Freeman, Private Parties, Public Functions and the New Administrative Law, reprinted in 52 ADMIN L. REV. 813, 816-17 (2000). See also Vincent-Jones, supra note 2, at 311-12 (conceiving of the problem of regulation in terms of deployment and interaction of a variety of regulatory resources “fragmented and dispersed among . . . state and non-state bodies”).

40. This is not to say that the procurement process functions efficiently or accountably. Federal military procurement has been famously corrupt and inefficient. See DONAHUE, supra note 2, at 101-03.


42. See sources cited supra note 41. The regime has attracted substantial criticism for overly burdening companies doing business with the government and for unnecessarily inflating prices and wasting taxpayer money. See Christopher F. Corr & Kristina Zissis,
commercial contracts, procurement contracts consistently favor government in a number of ways, by permitting termination for convenience, for example, and by limiting the remedies available to private contractors in the event of government breach.  

Although fraud and abuse frequently occur in the procurement process, as a conceptual matter, contracts to purchase “commercial” goods and services directly for government consumption are less troubling to administrative law than two other kinds of contracts: those that allow private actors to provide services for third parties and those that enable contractors to play significant roles implementing laws or otherwise performing the work of government agencies. The traditional procurement model, which consists of a highly technocratic approach to contract design—detailed specifications, elaborate procedures, formal agency supervision—may be somewhat amenable to controlling the excesses of commercial procurement, but it may be too limited to address the much more substantial issues that arise when government contracts out social services and traditionally governmental functions.

Moving away from procurement of goods for government consumption, we see that all levels of government contract with private providers for the delivery of social services and benefits such as health care, welfare benefits, job training, day care, and education.

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44. See, e.g., BURTON A. WEISBROD, THE NONPROFIT ECONOMY (1988); see also DONAHUE, supra note 2, at 179, 219-20 (discussing job training and health care contracts between government and private providers); SALAMON, supra note 25, at 10 (describing the growth of for-profit organizations in the social welfare field). Although secondary school education is still largely publicly provided, there are increasing trends toward privatization. California education secretary Gary Hart said recently that one of the major issues facing primary and secondary education is “the trend toward privatization.” Gary Hart, Presentation Before the UCLA Faculty of Law (Sept. 18, 2000). Not only is there a trend toward contracting out services like bus transportation and computer services, but governments are also contracting out instruction. For example, a San Diego organization called AVID provides half of all California high schools with a college prep curriculum aimed at low-income students. See id.
Private actors also provide amenities such as water and power and furnish basic municipal services such as waste collection.\textsuperscript{45} To fully appreciate the context in which contracting out of this sort has flourished, one must understand federal grants-in-aid, which are the funding vehicles through which the federal government enables and encourages state and local governments to achieve its policy goals.\textsuperscript{46}

Federal grants resemble contracts themselves\textsuperscript{47} but are more accurately described as conditional awards of funding.\textsuperscript{48} They are divided into mandatory and discretionary grants and again into cate-

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\item I focus on the supply of such services rather than the demand for them (which might also be contracted out, i.e., government might just abandon its role in determining whether a service or function is needed). Although state and local governments may follow the procurement model when contracting with private providers to deliver these services or benefits, I distinguish these contracts from the traditional procurement context because the services are for the benefit of third parties; these are not goods and services for the government's own use.
\item 46. Spending on grants has grown from $7 billion in 1960 to $135.3 billion in 1990 to $246.1 billion in 1998. Total federal grants as a percent of state and local expenditures has ranged from 19% in 1960 to a high of 31% in 1980 to 25% in 1998. See \textit{ANALYTICAL PERSPECTIVES}, supra note 34, at 236. Medicaid is the largest grant program, receiving $101.2 billion in 1998. See id. at 244. The federal government also relies extensively on grants and cooperative agreements with states and local government to effect legislative and administrative purposes. See 31 U.S.C. §§ 6304(1), 6305(1) (1994). These are known as “domestic assistance” contracts because they enable the federal government to carry out a “public purpose of support or stimulation authorized by a law of the United States.” Id. However, they are not contracts. Compare 31 U.S.C. §§ 6304(1), 6305(1) (addressing grants and cooperative agreements), with 31 U.S.C. § 6303 (1),(2) (1994) (addressing procurement contracts). See also PAUL G. DEMBLING & MALCOM S. MASON, \textit{ESSENTIALS OF GRANT LAW PRACTICE} 12-13 (1991).
\item 47. See DEmbling & Mason, supra note 46, at 1-8. While analogous in some respects to contracts, grants are not, strictly speaking, contracts. They are domestic assistance vehicles—funding mechanisms through which the federal government enables and encourages state and local government to accomplish federal goals. Because federal grants offer conditional inducements, they allow the federal government to accomplish indirectly what it cannot mandate directly. In exchange for federal funding, recipient governments must comply with certain conditions, which vary with the type of grant.
\item Analyzing these agreements using conventional contract analysis proves limited. Among other things, they do not conform to the usual requirements of offer and acceptance. For example, sometimes the agency attaches special conditions to the grant after it accepts the application. Normally this would be a counter-offer, but in the world of grants, the agency’s conditional award constitutes acceptance. See id. at 82. As another example, judicial review of denials of discretionary grants is limited because of principles of deference to agency action that would not apply to two private parties. See id. at 78-79. Decisions to award discretionary grants are considered by courts to be informal policy making, a mode of agency action over which courts hesitate to tread too heavily. See id. at 79. In essence, the fact that one “contractual” partner is the government makes it difficult to interpret them using conventional contract analysis. See id. at 8, 82.
\item 48. See, e.g., South Dakota v. Dole, 483 U.S. 203, 223 (1987). The procedures, conditions, remedies, enforcement, and overall administration of grants differ from the laws and regulations governing federal procurement contracts as well as from commercial contracts. See Dembling & Mason, supra note 46, at 3.
\end{itemize}
gorical (narrow purpose) and block grants (wide purpose).\textsuperscript{49} Discretionary grants are authorized by statute to further a specific purpose, such as medical research or education, and are more likely to be directly provided to nongovernmental (chiefly nonprofit) organizations.\textsuperscript{50} Federal agencies do not possess the inherent power to enter grant agreements as they do procurement contracts. Instead, Congress must explicitly provide for grants in legislation and authorize appropriations for the grant. As a result, there is no uniform statutory framework for grants as there is for procurement and they are subject to a variety of government-wide and agency-specific conditions. These conditions derive not only from statutes but from executive orders, agency regulations, grant policy manuals published by particular agencies,\textsuperscript{51} and recommendations from Office of Management and Budget (OMB) circulars.\textsuperscript{52}

The grant system not only allows the federal government to advance its substantive policy goals, but it also enables the federal government to indirectly regulate state and local governments and ultimately to impose conditions on the private providers of social services. As a condition of grants, Congress can demand conformity with its socioeconomic policies (such as anti-discrimination, environmental, and labor standards) as well as administrative and fiscal policies (such as compliance with record-keeping and inspection and auditing requirements).\textsuperscript{53} The power of these tools as instruments of policy is particularly striking now, as the Supreme Court’s federalism jurisprudence makes direct federal regulation of the states increasingly difficult.\textsuperscript{54} Conditional inducements in the form of grants-in-aid fall within Congress’ Article I spending power.\textsuperscript{55} Because a

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\item \textsuperscript{49} See DEMBLING & MASON, supra note 46, at 31.
\item \textsuperscript{50} Discretionary grants differ significantly from procurement contracts in that they permit agencies considerably more discretion in selecting grant awards, and accountability for compliance with their terms seems more contextually driven and ad hoc. See id. at 69. Discretionary grants are also distinguishable from procurement contracts in that they often amount to investments under conditions of uncertainty. See id. at 70.
\item \textsuperscript{52} By statute, mandatory grants entitle an applicant to the grant if the applicant meets specified criteria. See DEMBLING & MASON, supra note 46, at 33. Termination or denial of nondiscretionary grants often entitles potential recipients to a formal trial-type hearing before an administrative law judge. Discretionary grants do not typically offer such procedural remedies.
\item \textsuperscript{53} For example, in \textit{Dole}, 483 U.S. 203, the Supreme Court held that Congress’s use of conditional grants to indirectly encourage states to conform to national concerns like a uniform drinking age was a valid use of its spending power.
\item \textsuperscript{54} See Printz v. United States, 521 U.S. 898, 935 (1997) (holding that Congress cannot circumvent \textit{New York} by commanding state officials to enforce a federal regulatory program); \textit{New York v. United States}, 505 U.S. 144, 149 (1992) (holding that the federal government cannot compel a state to take title to its radioactive waste).
\item \textsuperscript{55} See U.S. CONST. art. I, § 8, cl. 1. Congress can regulate state policy indirectly through the inducement of federal money. The spending power is not, however, unlimited.
\end{itemize}
conditional grant is a “carrot” that a state can refuse, rather than a “stick” that it cannot, even heavily conditional grants that require states to pass legislation are not considered to be unconstitutionally “coercive” intrusions into state sovereignty.\textsuperscript{56} Much of this indirect regulation would undoubtedly be struck down by the Court if it were imposed directly. Thus, the grant conditions themselves become potentially critical accountability mechanisms in an era of privatization. They offer the federal government residual control over state and local governments which must, in turn, regulate private grant recipients to ensure that they comply with the grant conditions. The grant device effectively enables the federal government to purchase services for the benefit of third parties and regulate the delivery of the services simultaneously.\textsuperscript{57}

For example, when a state wishes to receive federal Medicaid funding, it must file a state plan that assures compliance with various provisions of the Social Security Act, the Balanced Budget Act, and a host of federal regulations promulgated by the Department of Health and Human Services (HHS).\textsuperscript{58} Compliance with these requirements is a condition of receiving the program funds. Among other things, federal regulations include requirements that apply to contracts between the state agency and the private institutions that ultimately deliver health care, including hospitals and managed care organizations (MCOs).\textsuperscript{59}

\textsuperscript{56} See Dole, 483 U.S. at 207-08 (upholding a statute conditioning the receipt of highway funds on adoption of a minimum drinking age of 21). The Court has struck down a conditional grant only once. See United States v. Butler, 297 U.S. 1, 68 (1936) (invalidating a statute authorizing payments to farmers who agreed to curtail acreage or production). The curtailment scheme in Butler went “beyond the presumptive powers of Congress.” Albert J. Rosenthal, \textit{Conditional Federal Spending and the Constitution}, 39 STAN. L. REV. 1103, 1126 (1987).

\textsuperscript{57} See id. at 1113; see also Kathleen M. Sullivan, \textit{Unconstitutional Conditions}, 102 HARV. L. REV. 1415, 1415 (1989) (demonstrating that the Court has subjected conditions that interfere with individual rights to heightened scrutiny). Conditioned grants are a staple of cooperative federalism and are common in environmental statutes. For example, section 179 of the Clean Air Act conditions receipt of federal highway funds upon compliance with the Act. See 42 U.S.C. § 7509 (1994). But see Cass R. Sunstein, \textit{Is the Clean Air Act Unconstitutional?}, 98 MICH. L. REV. 303 (1999).


The relationship between the federal agency responsible for Medicaid oversight (the Health Care Financing Administration) and the doctors and nurses who ultimately provide health care to Medicaid eligible patients is therefore highly attenuated. However, it is through a series of contractual agreements—federal government with state, state with health care institutions, and institutions with providers—that the federal government exercises coercive power over health care delivery.

In addition to providing the funding stream for contracts that deliver social services to third-party beneficiaries, government grants also enable large transfers of money to private contractors to perform executive work that we associate with the “civil service.” Numerous federal agencies rely heavily on a private work force to assist them in implementing laws and regulations. While I focus in this Article on services and functions that contractors deliver directly to third-party beneficiaries, the extent to which agencies rather invisibly rely on private actors to execute their every day functions of policy making and implementation warrants attention as well. Among other things, private contractors remain relatively unencumbered by the conflict of interest and other ethical rules that apply to civil servants.

A. Objections to Contracting Out

1. Consequentialist Concerns

Typically, one’s enthusiasm for contracting out turns on a host of considerations, most of which could fairly be labeled “consequentialist” because they are motivated solely by a concern about the results of contracting out, rather than whether contracting out conforms to a set of a priori principles of “moral” action. That is, the objection to contracting out would disappear if it were possible to ensure favorable results, such as cost savings without a concomitant decline in quality.

61. See id. at 875-76.
62. See id. at 894-95.
63. Consequentialism is the moral theory which holds that the rightness or wrongness of an action depends exclusively on the consequences generated by that action. See Sharon Dolovich, The Ethics of Private Prisons 75 (Nov. 1999) (unpublished manuscript, on file with the Florida State University Law Review) (citing Bernard Williams, A Critique of Utilitarianism, in J.J.C. Smart & Bernhard Williams, Utilitarianism: For and Against 79 (1973) (describing consequentialism as a form of utilitarianism)).
64. See id. at 72-73 (distinguishing between consequentialist and deontological theories of moral action).
In fact, for the most part, scholars do not question the legitimacy or “morality” of private service provision. Rather, the key question is whether privatization can deliver on its promised efficiency gains without sacrificing quality service. As a result, scholars are prone to note the host of factors—geographic, demographic, and economic—that can thwart efforts to achieve efficiency gains through contracting out. These include such problems as an absence of competition, a lack of opportunities for cost savings, or the small size of a market.  

In some cases, the task that government wishes to contract out may be too difficult to specify in a contract and, therefore, difficult to monitor. Because the case for privatization has sounded largely in the language of cost savings and, to some extent increased effectiveness, demonstrating whether these gains will in fact obtain has become both politically and practically important to the privatization movement. Those who support privatization on such instrumental, rather than ideological, grounds are advocates of what one scholar calls “pragmatic privatization.”

Thus, opposition to contracting out may stem from worry about results alone, which is ultimately an empirical question. For example, one might oppose privatizing welfare benefits on the theory that it will not cut costs and might result in the “creaming” or “churning” of welfare recipients to limit the numbers of claimants. Similarly, one might oppose prison privatization on the theory that it will fail to ameliorate overcrowding and might in fact swell the prison population due to the incentives that private contractors face to maintain high numbers of inmates.

In a results-oriented framework, then, we would want to ensure that contracting out in fact produces the positive benefits we desire without producing the negative effects we seek to avoid. In the context of prison privatization, for example, we would prize cost savings and bureaucratic efficiency, and perhaps even superior performance in rehabilitation and recidivism, but we would fear degraded prison conditions and increased threats to inmate security. Assessing any one instance of contracting out requires that we pay attention to context: we would want to know more about the potential for efficiency gains and more about the trade-offs.

2. “Technocratic” Concerns

To some extent, objections to contracting out might be ameliorated by careful attention to contract design. Contracts could specify tasks

65. See Deller, supra note 45, at 149-50.
67. For definitions of creaming and churning, see Kennedy, supra note 31, at 241-47.
more clearly, detail procedures more thoroughly, and clarify responsibilities. Certainly, many public-private contracts suffer from these “technocratic” weaknesses. However, there is a limit to technocratic solutions. No matter how careful the drafter, some tasks are difficult to specify in contractual terms (for example, delivering quality health care or providing a safe environment for prisoners). For many important services and functions contractual incompleteness is inevitable. No contract can be specific enough to anticipate any and all situations that a private provider might encounter. Instead, the contract becomes a framework and a set of default rules that will help direct future gap filling. In fact, contractual vagueness may be desirable in some circumstances, as, for example, when the parties are familiar with each other, have been repeat players, and have established trust. Even so, vagueness may impede meaningful monitoring.

For those functions that are easier to specify, agencies may be nonetheless ill-equipped to monitor performance, whether because of

68. A GAO report studied six governments’ (five states’ and one city’s) experiences with privatization. Government officials reported that contract monitoring is key and consists of both contract auditing, which ensures that contractors are paid and contract obligations are met, and technical or performance monitoring, which ensures that the contractors meet the quantity and quality terms of the contract. Generally, performance monitoring is more difficult than contract auditing for several reasons. Government employees need training in order to perform sophisticated analysis and monitoring. Contract requirements need to be precise to allow effective monitoring. Whether a service’s objectives could be defined easily and measured for monitoring purposes factored into some states’ decisions to privatize the service. Also, all the state government officials noted that performance monitoring is the weakest link in their privatization activities. See GENERAL ACCOUNTING OFFICE, GAO/GGD-97-48, PRIVATIZATION: LESSONS LEARNED BY STATE AND LOCAL GOVERNMENTS 17 (1997), http://www.access.gpo.gov/su_docs/aces/aces160.shtml.

69. Even procurement contracts can be incomplete and vague, and although design specifications might change, for the most part, in the procurement context government is buying a definable product (an F-15, for example). On the frequency with which “constructive change” orders have historically been issued by government personnel supervising procurement contracts, see F. Trowbridge vom Baur, Differences Between Commercial Contracts and Government Contracts, 53 A.B.A. J. 247, 250 (1967).


resource constraints or a lack of familiarity with contract management. Weak monitoring in turn makes it difficult to discern whether contracting out is producing the desired results. Of course, some of these problems are related. Government agencies may monitor inadequately because the task described in the contract itself eludes definition. They might be unrelated, however. Agency staff may monitor poorly because of an absence of training, because their incentives direct them toward other priorities, or because they are corrupt.

3. Ethical Concerns

More fundamentally, one might object to contracting out certain functions on moral grounds. Many people have a viscerally negative reaction to the idea that some government functions—those they view as symbolically important or inherently governmental—might be contracted out to private parties, notwithstanding the possibility that private actors may perform those functions more cost-effectively. Some draw the line at what they call “core” governmental functions—those believed to be at the heart of sovereignty, such as foreign affairs, tax collection, national defense, and policing, for example.72 For them, the distinction turns on the belief that certain functions are traditionally the obligation of the state.73 The same impetus to reserve “core” functions to the state motivates the desire to keep the heart of regulatory power in the hands of government, thus allowing implementation, but not policy making, to be contracted out.

While there might be widespread agreement that a few functions (such as national defense) ought to be both financed and performed by the state, choosing where to draw the line between these and other nonessential or peripheral functions, and the reasons for drawing the line, remains a matter of debate. Different people would no doubt consider different functions to be the inherent responsibility of the sovereign; in addition to the four examples listed above, educa-


73. In fact, most so-called public functions are neither traditionally nor self-evidently inherently governmental. Private prisons predated public ones. Private police predated the public police. See David A. Sklansky, The Private Police, 46 UCLA L. REV. 1165, 1198-2000 (1999). Private charitable organizations predated the social insurance schemes of the New Deal. Nonetheless, some commentators believe that certain functions ought to be reserved to the state because of their moral and symbolic importance. See PRIVATE PRISONS AND THE PUBLIC INTEREST 155, 173, 176 (Douglas C. McDonald ed., 1990)(arguing that some functions, such as the incarceration function, are so inherently public that it is immoral to privatize them). For an argument that the market is not an appropriate mechanism for producing and distributing collective goods such as education and health care, see MICHAEL WALZER, SPHERES OF JUSTICE: A DEFENSE OF PLURALISM AND EQUALITY 86, 198 (1983).
tion, civil and criminal adjudication, and even transportation plausibly merit inclusion in the “core” category.

Some commentators object to prison privatization on these grounds, arguing that criminal punishment, an expression of society’s moral condemnation, is a core state function—the kind of judgment that, in a democratic society, ought to be imposed by the state. In this vein, John DiIulio argues that incarceration is part of the state’s inalienable “duty to govern.”74 Sharon Dolovich similarly frames her objection to privatization in “expressivist” terms, claiming that prison privatization sends the wrong message about the values of a “liberal ethical society.”75

Whether we label such objections symbolic, ethical, traditionalist, deontological, or expressivist, the simple notion behind all of them is that contracting out certain functions is somehow corrosive of democratic values. Absent a strong grounding in moral theory, these objections can sound vague, tautological, and decidedly nonempirical,76 especially compared to the hard-nosed efficiency arguments of privatization advocates, but they are real and pervasive.77 Many people simply distinguish intuitively between those services and functions that might tolerably be assigned to private parties and those they believe ought to be performed by government. An individual who cares little about whether her household garbage is collected by the city of New York or Acme Waste Corporation may feel quite differently about the identity of a prison guard or a police officer.78

On this score, the potential for coercion is an important consideration in whether we view contracting out as legitimate, and it merits singling out. Some functions allocate burdens as opposed to benefits. Commentators may believe that when people are forced by the state to suffer a burden, contracting out is particularly inappropriate, and that administering coercion in particular ought to be the job of the state. Because burdens can implicate civil liberties, safeguards on the exercise of authority and accountability are all the more important. Thus, when government contracts out the power to punish, just

75. Dolovich, supra note 63, at 76.
76. Most functions that seem traditionally governmental, including tax collection, policing, and incarceration, were at one time or another performed by private individuals or organizations. See DONAHUE, supra note 2, at 34 (commenting on the “tax farmers” of ancient Rome and the historical proliferation of mercenary armies). To say that a function is “traditionally” or “inherently” governmental still requires an argument.
77. See, e.g., John J. DiIulio, Jr., What’s Wrong with Private Prisons, 92 PUB. INTEREST 61, 70-71 (1988); Dolovich, supra note 63, at 71 (articulating an “expressivist” critique of prison privatization that goes beyond “consequentialist” arguments about cost and quality).
78. On the history of private policing, see Sklansky, supra note 73, at 1165.
as when it delegates its coercive regulatory authority, we might worry more than when government contracts out responsibility for conferring benefits, such as publicly financed health care, education, or job training.

Consider, again, the difference between contracting out waste collection and prison operation. Although everyone has an interest in the proper collection of waste (particularly given the environmental and human health risks posed by improper collection, transportation, and disposal), this activity seems not to implicate civil liberties. We simply do not experience the waste collection function as coercive. For the most part, then, whether waste collection and services like it ought to be provided by government or private actors appears to be less a normative question and more a question of which institution can do a better job for less money. For a large percentage of services and functions then, we are more likely to ask the type of questions characteristic of the “pragmatic” view of privatization: Will the contractual regime be adequately competitive to ensure cost savings and high quality? Will the bidding process be corrupt? With this kind of function, the only relevant normative question might be whether the community is willing to trade labor losses for more efficient service.\(^9\)

Realistically, however, there are few activities with as much potential for coercion as incarceration. Few social services or functions funded by government but provided by private parties raise as much alarm over civil liberties, even if they affect important interests. Indeed, incarceration is unique. As a society, we are still considering whether to proceed with the experiments in private prison management, and at least with this particular function, the federal and state governments might still turn back. By contrast, there is little chance of retreating from the private delivery of most social services. The public-private networks necessary to accomplish “public” ends have been developing for at least half a century, and they appear well entrenched. In any event, there appears in the United States (and indeed worldwide) to be little public appetite for relying directly on government itself to deliver most social services. In an era marked by antipathy toward government bureaucracy, neither technocratic nor ethical objections are likely to deter the trend toward contracting out.

4. Administrative Law Concerns

For the most part, I have argued, economists and public management scholars engaged in the privatization debates focus on the con-

\(^{79}\) See Graham & Prosser, supra note 36, at 63 (noting that severe job losses have coincided with privatization but falling short of arguing causation). Anticipating job losses or less favorable work conditions, public service employees unions raise the strongest objections to such privatization schemes. See id.
ditions under which private provision will offer greater efficiency than direct government provision. The goal of this results-oriented inquiry is to identify the economic conditions that might obstruct government efforts to structure privatization most effectively. In this view, technocratic problems of contract design are thought to be fairly and easily solved with more careful drafting and greater specificity. Accountability arises, if at all, as one of these technocratic problems that might be addressed by a tweak of drafting and design; formal agency oversight usually suffices for accountability.

However, contracting out presents serious and complicated questions about the rationality, public participation, openness, and accountability of publicly funded and privately conferred services—concerns that are likely to be important to administrative law scholars and not easily assuaged. From an administrative law perspective, then, we would ask different questions: whether contracts for social service delivery are produced in a fair and open manner with sufficient public input, and whether they afford procedural protections, including private rights of action, to third-party beneficiaries. In addition, we might inquire into the potential conflict between public law norms of deference to agencies and private law principles of contract interpretation when it comes to adjudicating disputes.

Contracting out raises a version of the principal-agent problem that arises whenever legislatures delegate decisionmaking authority to public bureaucracies. Because third-party beneficiaries (and the general public) are one step further removed from the private provider than from the agency, however, the possibility of meaningful public oversight becomes increasingly remote. The obstacles to third party vindication seem particularly objectionable from an adminis-
The constitutional constraints and elaborate procedural rules that govern agency decisionmaking only infrequently apply to private decisionmaking undertaken pursuant to public-private contract. Procedural rules, such as the requirement of notice and comment prior to the promulgation of a rule, provide points of entry for members of the public affected by the regulation and grounds to challenge ensuing policy choices. However, analogous opportunities for public access appear to be absent in the contracting process. For example, public-private contracts for health care delivery often incorporate statutory and regulatory requirements, making those requirements enforceable as contractual terms. Through the incorporation of regulation into contract, Medicaid contracts for health care delivery can function as a means of standard setting. And yet the contracting process lacks the procedural safeguards that characterize traditional notice-and-comment rulemaking.

Once contracts take effect, moreover, beneficiaries enjoy few procedural rights to challenge decisionmaking that affects their interests. Although courts might imply third-party beneficiary rights into contracts, the documents themselves almost never explicitly afford beneficiaries the right to sue. The absence of public participation or third-party rights of enforcement are particularly notable in light of the risk of ineffective agency oversight. Even when agencies have at their disposal the means to constrain private discretion, imposing constraints may be unappealing for political reasons or practically infeasible.

These issues arise even more strikingly when governments contract for especially controversial functions, such as private prison management.84 Contracts between private prisons and state agencies can be highly detailed and specific, and in many respects (for example, the issuing of requests for proposals and the competitive bidding process) they conform to the traditional procurement model. At the same time, because of the unique service for which government is contracting, the need for such contracts to provide accountability is acute.

a. Examples.—To illustrate the administrative law concerns that arise when states contract out social services or important functions, I draw on three examples of contracting that I have developed in

84. Although only 3% of the prison population has been privatized—and although most of these are either juvenile facilities, INS detention centers, or low security facilities—there is a marked trend toward prison privatization in many states. See Hart et al., supra note 80, at 1147, 1154.
greater detail elsewhere: nursing homes, the federal Medicaid program, and private prisons. 85

i. Nursing Homes.—Consider, for example, the mechanism by which the federal government funds the provision of health care to Medicaid patients in private nursing homes. 86 Under the federal Medicaid program, the federal government reimburses states for Medicaid-eligible patient care. Medicaid funding overwhelmingly supports the private nursing home industry, subsidizing capital and operating expenditures and reimbursing more than sixty percent of eligible patient care. 87 To qualify for participation in the federal program, states must comply with a complicated body of federal law and regulation. States in turn rely on a combination of licensing, regulation, and contract to impose obligations on the private nursing homes that deliver the care. 88 Thus, private homes cannot collect reimbursement from the state unless they comply with a state-provider agreement (a public-private contract) governing care delivery. 89

Although private nursing homes are arguably the most heavily regulated of all health care delivery institutions in the United States, 90 these public-private contracts still raise significant adminis-
trative law concerns. First, private litigants enjoy “no rights or protectable expectations” regarding the care they receive from nursing homes. That is, despite extensive federal and state regulation, nursing homes are not considered “public” providers of health care. Thus, private denials of care and private eviction determinations do not constitute state action, eliminating constitutional due process claims as a mechanism of oversight.

Second, nursing home residents face significant obstacles to enforcing contractual terms as third-party beneficiaries. Courts only reluctantly find state-provider contracts to be a source of third-party beneficiary claims against nursing homes for statutory violations. While nursing home residents might argue that the federal Medicaid statute creates an implied private right of action, as a general matter, courts rarely recognize private rights of action to redress violations of federal law. As with third-party beneficiary claims, to the extent that courts have recognized implied rights of action, they have done so to enforce “specially iterated rights” stipulated in legislation, such as those covering wrongful transfer or eviction decisions by the

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91. Armour, supra note 88, at 254 (noting that providers’ lack of duty beyond the regulatory structure limits patients’ private right of action).


93. Federal courts have, on occasion, held private providers to be state actors when they are the only providers of care in a government-regulated arrangement and where they therefore assume responsibility for the state’s mandated health care duties. See Catanzano v. Dowling, 60 F.3d 113, 120 (2d Cir. 1995) (holding state-certified home health agency determinations regarding medical necessity of home health care to be state action since only certified home health agencies can provide care to Medicaid beneficiaries); J.K. v. Dillenberg, 836 F. Supp. 694, 698-99 (D. Ariz. 1993) (holding that private regional behavioral health authorities were state actors where they were the sole providers of the state’s Medicaid behavioral health services for children).

94. See Anthony Jon Waters, The Property in the Promise: A Study of the Third Party Beneficiary Rule, 98 HARV. L. REV. 1109, 1174-78 (1985) (describing some federal courts’ holdings that third-party beneficiaries have no private right of action on the contract where the claim is traditionally relegated to state law); cf. Martinez v. Socoma, 521 P.2d 841, 849 (1974) (denying unemployed residents’ claim as third-party beneficiaries to federal training and employment contracts with local corporations because residents were merely incidental beneficiaries of the public purpose behind the contracts).

95. See Fuzie, 461 F. Supp. at 694-95, 697 (holding that a private nursing home was not a state actor and that the plaintiff had no implied private right of action under Medicaid regulations, but finding that the plaintiff-patient did have a claim as a third-party beneficiary under the contract); see also Waters, supra note 94, at 1186-88 (describing Fuzie as an example of courts using the third-party beneficiary rule to create a private right to enforce public programs regardless of legislative intent).

96. See Richard B. Stewart & Cass R. Sunstein, Public Programs and Private Rights, 95 HARV. L. REV. 1193, 1302-06 (1982) (arguing that the Supreme Court has created a strong presumption against judicial recognition of private rights of action). Although some states have passed legislation affording patients private rights of action, this legislation often limits them to such specific rights as eviction rather than general standards of care. See Armour, supra note 88, at 259-60.
home. As a result, only patients who are wrongly evicted, but not those who receive substandard care, would have any chance of success using either of these arguments.

Alternatively, residents might seek to enforce the terms of their own contracts with providers (typically, new residents sign contracts upon admission to the nursing home). However, absent express contractual representation to the contrary, courts tend to interpret admission contracts according to tort standards of quality of care, which usually disfavor residents. Relying on state or federal enforcement of provider contract terms may be no more promising for residents than taking matters into their own hands. Contractual terms in the state-provider agreements may be vague or agency monitoring insufficient, due to a long tradition of relatively weak government oversight. Absent vicarious liability, the contracting agency may lack sufficient motivation to supervise the provider’s compliance with the agreement. In fact, governments have historically taken a more aggressive approach to negotiating and monitoring procurement contracts than they have with regard to contracts governing the delivery of benefits.

Even when an agency is armed with a detailed contract and a variety of enforcement tools, however, its interest in the operation of the contractual regime may not (and often will not) coincide with that of the ultimate consumer. An agency may care more about cost savings and blame shifting than quality of service, or it may be

97. See Armour, supra note 88, at 259-60.
98. See id. at 266-70 (summarizing standard critiques of the tort paradigm’s application in the nursing home context).
99. Historically, governments have purchased services like health care differently than they have procured goods such as airplanes. See BRUCE C. MADECK, UNLOVING CARE: THE NURSING HOME TRAGEDY 98-99 (1980).
100. For example, procurement contracts obligate suppliers to meet specific performance standards, whereas until recent years, state provider agreements rarely contained either performance standards or penalties for nonfulfillment. See id. at 98 (arguing that in the 1970s there was “no comparison between a typical government procurement contract and a typical ‘provider agreement’ between a state Medicaid agency and a nursing home”). While in theory the nursing home is required to meet all the requirements of the state’s licensing and health codes, “the separation of the enforcement from the purchasing function seriously limits [the codes’] enforceability.” Id. at 99. On the weaknesses of reimbursement as a quality assurance tool when the Medicaid agency is not the licensing certification agency, see Butler, supra note 26, at 1329. Inattention to contracting details flowed from Medicaid’s roots as a redistributive claims processing operation.
101. There is nothing about the divergence of agency and Medicaid beneficiary interests that is unique to managed care. As an outgrowth of welfare cash assistance programs, Medicaid has always had a “corporate culture” of saving money and preventing fraud. Historically, insurance programs like Medicaid have had no responsibility for the health of beneficiaries. I thank Elizabeth Wehr for helpful comments on this point.
102. See James W. Fossett, Managed Care and Devolution, in MEDICAID AND DEVOLUTION, supra note 27, at 106, 120 (“The major continued political appeal of managed care rests on its perceived ability to produce budget savings while shifting financial risk and political blame for spending reductions to private agencies.”).
more interested in maintaining smooth relationships with its contractual partners over the long term than in individual fairness or responsiveness to consumers in the short term. Even a well-meaning agency may be torn between competing goals. The price of closer scrutiny over private providers of care could prove to be the flexibility, cost savings, and innovative capacity associated with relying on private providers in the first place—a trade-off that some agencies may not be willing to make.

ii. Medicaid and Managed Care.—Beyond the nursing home environment, the Medicaid program offers another useful example of how public-private contracting to deliver social services is fraught with accountability problems. To obtain health care for Medicaid recipients, state Medicaid agencies purchase care from a range of providers. In recent years, state agencies have shifted from employing a fee-for-service system to purchasing care for Medicaid beneficiaries from Managed Care Organizations (MCOs). As a result, states increasingly require Medicaid beneficiaries to choose among the MCOs offered by the state, much like employees in firms might choose from a menu of managed care providers offered by their employers. The Balanced Budget Act of 1997 explicitly authorizes this practice by eliminating the prior requirement of a federal waiver for mandatory enrollment of Medicaid beneficiaries in managed care. Thus, states can now require Medicaid beneficiaries to enroll in managed care plans from which they may disenroll only “for cause” or at prescribed times.

Moreover, devolution of decisionmaking authority—a phenomenon that has coincided with the trend toward contracting out and which has specifically occurred in the Medicaid regime—can exacerbate monitoring problems associated with contractual relationships by adding the need for greater intergovernmental monitoring to government-provider monitoring. In addition, as mentioned above, devo-

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103. See John T. Boese, When Angry Patients Become Angry Prosecutors: Medical Necessity Determinations, Quality of Care and the Qui Tam Law, 43 ST. LOUIS U. L.J. 53, 56 (1999) (reporting that nearly 17% of Medicare patients are enrolled in managed care programs). In a fee-for-service system, consumers of health services rely on their physicians to determine the care they need and insurance companies compensate providers based on the volume and type of services provided. In theory, managed care responds to the tendency to overconsume health care by requiring primary care physicians with no financial stake in overtreatment to perform a “gatekeeping” function in determining the care required. See id. at 58-60.


ution can lead to significant dependence on private actors to deliver services for which states and localities find themselves newly responsible, or it can intensify a dependent relationship that already exists.106

For example, the federal block grants that have replaced the entitlement to federal financial assistance for the poor in the Personal Responsibility and Work Opportunity and Reconciliation Act of 1996107 (PRWORA) allow states, with few conditions, to design benefit programs and eligibility requirements for welfare recipients.108 As a result, the Act will likely accelerate the existing trend toward greater reliance on nongovernmental actors.109 The PRWORA specifically allows states to operate welfare programs “through contracts with charitable, religious, or private organizations.”110 Nongovernmental

106. See Kennedy, supra note 31, at 231 (describing Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRA) as permitting states to use private corporations to operate benefit programs). For a detailed description of the Temporary Assistance to Needy Families block grant (which replaced Aid to Families with Dependant Children (AFDC)) and the Child Care and Development block grant, see Mark Greenberg, Welfare Restructuring and Working Poor Family Policy: The New Context, in HARD LABOR: WOMEN AND WORK IN THE POST-WELFARE ERA 24, 33-34 (Joel F. Handler & Lucie White eds., 1999). Under the prior AFDC regime, states were obligated to provide benefits to individuals eligible under federal law. See id. at 25.
108. Pursuant to the PRWORA, states now determine for themselves which populations to serve and exercise very broad discretion in spending block grants, provided that they do so in a manner designed to accomplish the permissible purposes specified in the Act, such as providing assistance to needy families. See Greenberg, supra note 106, at 31.
109. The new balance of power between state and federal governments under the PRWORA has attracted considerable attention, but the reallocation of authority from states to private corporations as a result of welfare reform may be more significant than the new balance of authority between the federal and state governments. See Kennedy, supra note 31, at 232 (suggesting that the federal-state balance might return to federal dominance but that authority ceded to the private sector will be harder to regain). Under the law, the state has no obligation to provide assistance for low-income families. See Greenberg, supra note 106, at 31. A state wishing to do so has considerable flexibility. It could provide assistance through cash or noncash means or fund social services rather than providing other forms of assistance. See id. A state could also “turn over some or virtually all funding to nonprofit organizations, religious groups, or for-profit organizations for an array of different approaches.” Id. at 37. Prior to passage of the PRWORA, many states were already experimenting with time limits, work requirements and, most importantly for our purposes, “privatizing” aspects of their welfare systems; the federal government had routinely granted states waivers under the AFDC program in order to allow them flexibility in administering benefits. See id. at 25-28 (describing state initiatives as a mixture of expansion and contraction of program eligibility). For a critical view, see Lucy A. Williams, The Abuse of Section 1115 Waivers: Welfare Reform in Search of a Standard, 12 YALE L. & POL'Y REV. 8 (1994) (arguing that unrestricted state discretion is an inappropriate strategy for addressing welfare policy concerns).
110. Pub. L. No. 104-193, § 104, 110 Stat. at 2161. Major corporations anticipating a significant role in welfare administration not only lobbied in support of the legislation but also rushed to capitalize on it. See Kennedy, supra note 31, at 258-59.
organizations increasingly will deliver benefits, exercising the considerable discretion that “administration” and “delivery” imply.\textsuperscript{111}

Of course, welfare reform represents a wholesale devolution of authority that dwarfs the more modest devolution exemplified by the Medicaid regime, but both examples illustrate how devolution can indirectly empower nongovernment decision makers to make important policy determinations that go far beyond the mere implementation of government directives. Devolution in the Medicaid context not only increases reliance on private health care institutions, it also indirectly increases state government dependence on private accreditation bodies such as the National Committee on Quality Assurance (NCQA) to certify that private health care delivery organizations (including MCOs) meet adequate standards of care.\textsuperscript{112} Until recently, NCQA certification was primarily voluntary—it offered MCOs an advantage when competing for lucrative health care delivery contracts. However, when states became managed care purchasers, they adopted the benchmark of quality for managed care endorsed by

\textsuperscript{111} Critics worry that private firms administering welfare benefits will maximize profits by “churning” and “creaming” recipients, effectively making policy decisions about who will receive benefits. “Churning” refers to the variety of burdensome administrative procedures used to dissuade potential beneficiaries from applying for benefits, including requiring applicants to comply with extremely complicated verification and documentation requirements, subjecting them to interminable waits, and locating facilities in inconvenient locations. See \textit{Kennedy, supra} note 31, at 241-47. “Creaming” refers to finding the best qualified beneficiaries jobs while allowing the bulk of beneficiaries to languish and eventually be dropped from the rolls. See \textit{id.} at 263.

\textsuperscript{112} The NCQA is a private, nonprofit organization that assesses and accredits health plans. It is governed by a board of directors consisting of employers, consumer and labor representatives, health plans, quality experts, policy makers, and representatives from organized medicine. See \textit{NCQA, National Committee for Quality Assurance: An Overview}, at http://www.ncqa.org/Pages/about/overview3.htm (visited Apr. 4, 2000); see also 1 \textit{SARA ROSENBAUM ET AL., GEORGE WASHINGTON UNIV. M.D. CTR., NEGOTIATING THE NEW HEALTH SYSTEM: A NATIONWIDE STUDY OF MEDICAID MANAGED CARE CONTRACTS} (Kay A. Johnson ed., 2d ed. 1998) [hereinafter \textit{NEGOTIATING THE NEW HEALTH SYSTEM}] (noting that “state Medicaid agencies, like other purchasers, elect to rely on managed care organizations to conduct their own quality assessment and improvement efforts, as well as (increasingly) on the industry accreditation process”), http://www.gwumc.edu/chrp/overview/overview.htm (last visited Oct. 23, 2000). As MCOs proliferate, the accreditation process for health plans becomes more competitive. Competitors of NCQA are the Joint Commission on Accreditation of Healthcare Organizations (JCAHO), the Accreditation Association for Ambulatory Health Care, the Foundation for Accountability, the Medical Quality Commission, and the Utilization Review Accreditation Commission. See \textit{John K. Iglehart, The National Committee for Quality Assurance, 335 NEW ENG. J. MED. 995, 998 (1996)}. Further, although the MCO accreditation program is voluntary and rigorous, it has been well received by the managed care industry, and almost half the HMOs in the nation, covering three quarters of all HMO enrollees, are currently involved in the NCQA accreditation process. For an organization to become accredited by NCQA, it must undergo a survey and meet certain standards designed to evaluate the health plan’s clinical and administrative systems. In particular, NCQA’s accreditation surveys look at a health plan’s efforts to continuously improve the quality of care and service it delivers. One measure of the value of accreditation is the growing list of employers who require or request NCQA accreditation of the plans they do business with. See \textit{NCQA, supra}. 
commercial purchasers, which was, at the time, private accreditation. 113

From an administrative law perspective, managed care contracts between state agencies and MCOs raise serious questions about fairness and access for beneficiaries. Through contract, the parties incorporate existing federal and state standards and agree to terms under which states will consider them satisfied. Unlike traditional rulemaking, however, contract negotiation does not afford either the general public or Medicaid beneficiaries a role in decisionmaking.

Negotiating contracts against the backdrop of elaborate federal regulations also introduces considerable risks for the state agency which translate into accountability concerns for the public. As a recent report describes, “[S]tandard setting through contracts holds unprecedented enforceability implications, because of the legal consequences of drafting error or omission on the agency’s part.” 114 Should states carelessly draft state-provider contracts, they could find themselves directly responsible for services and benefits that they intend to pass on to private MCOs. 115 Agencies may nonetheless prefer contractual instruments because they are procedurally easier to manage than direct regulation of health care delivery through the traditional rulemaking process alone, even when this managerial benefit may come at the expense of public participation.

In addition, public-private contracts might compromise the deference agencies normally receive when they act in their regulatory capacity. Although administrative law principles suggest that courts should defer to an agency’s subsequent interpretation of its publicly promulgated rules, courts may interpret contracts according to private contract principles. 116 Unlike administrative law, contract law prohibits unilateral amendment at the behest of the agency or unilateral interpretation in the form of guidance documents. Thus, an agency may find itself, even if only temporarily, bound to a bad bargain and unable to alter it through a simple interpretive decision or rulemaking process. States may choose to avoid these complications by codifying contractual terms in state law or promulgating them as regulations. This would create accountability of a sort, but perhaps

113. See NEGOTIATING THE NEW HEALTH SYSTEM, supra note 112, http://www.gwumc.edu/chrp/overview/overview.htm; see also Iglehart, supra note 112, at 995.


115. Pursuant to state plans filed with the federal government, states are obligated to provide care to Medicaid patients in a manner consistent with statutory and regulatory standards. See id. As the report notes, residual liability from poor contract drafting is “unique to Medicaid.” Id. Health benefit plans offered by private employers are governed by the Employment Retirement Income Security Act, which imposes “almost no federal content or structural requirements[,] and [they] are exempt from most state laws.” Id.

116. See id.
at the expense of flexibility. Codification and promulgation necessarily render the contracting process more cumbersome, time consuming, and rigid.\textsuperscript{117} At this stage in their development, Medicaid contracts vary widely across states; some are highly specific, leaving little discretion to managed care plans, while others delegate substantial discretion to contractors in making coverage, operational, and administrative decisions.\textsuperscript{118} Under most contracts, private companies rather than states select and design their provider networks and oversee provider performance.\textsuperscript{119} The need to monitor their contracts with MCOs poses significant challenges for state bureaucracies, which frequently lack a comprehensive approach to data collection and processing.\textsuperscript{120} State monitoring of MCOs may be even more attenuated than their monitoring of other health care delivery institutions, such as nursing homes, because of the intermediary role played by private quality assurance bodies like the NCQA. A managed care regime may rely more heavily on independent accreditation and private assessments of quality of care even though assessments are more difficult to make in the managed care environment than in the hospital setting.\textsuperscript{121} Finally, some observers argue that states will wield limited influence with MCOs, which serve a broad array of nongovernmental clients, such as private employers.\textsuperscript{122}

As in the nursing home environment, consumers enjoy few opportunities for redress in the Medicaid managed care regime. Patients often lack the information and resources necessary to challenge benefit denials or protest substandard care in managed care organiza-

\textsuperscript{117} The report notes that a few states have codified the service and performance specifications in Medicaid managed care contracts in state regulations. This “merger of regulation and contract” gives the state the flexibility to unilaterally interpret contractual provisions and receive deference from courts. It also enables the agency to make unilateral post-contract modifications obviating the need for negotiating amendments. Thus, contracts from these states may provide only a framework for incorporating the relevant regulations. See \textit{id}.

\textsuperscript{118} See \textit{id}.

\textsuperscript{119} See \textit{id}.

\textsuperscript{120} Reporting requirements can be idiosyncratic. States have differential capacities both to identify the information that would be most useful and to analyze it critically. See \textit{id} (noting the need for Medicaid agencies to supplement internal analytic capabilities through agreements with other state agencies and institutions specializing in data analysis).

\textsuperscript{121} Given the relatively short periods of time for which most Medicaid beneficiaries are eligible for the program (and hence managed care coverage), and the special needs of this population, commercial standards of quality are relatively uninformative. Thus, special methodologies beyond those used in traditional private accreditation might be necessary to evaluate whether MCOs provide the Medicaid population adequate care. See \textit{id}. For the claim that private health care providers may not be as familiar with Medicaid beneficiaries as public providers, see Jane Perkins & Kristi Olson, \textit{An Advocate's Primer on Medicaid Managed Care Contracting}, \textsc{Clearinghouse Rev.}, May-June 1997, at 19, 21.

\textsuperscript{122} Interview with Sharon Connors, Consultant, Medimetrix, Boston, Mass. (Aug. 17, 1999).
Even though the Balanced Budget Act requires MCOs to establish internal grievance procedures, many of the same obstacles to consumer enforcement of agency-provider contracts identified in the nursing home example—judicial reluctance to declare MCOs state actors, absence of private rights of action, and tenuous third-party beneficiary claims—apply in this context. Due Process claims, for the most part, fail: only rarely will private health care providers be declared state actors.

Indeed, the Supreme Court recently vacated a Ninth Circuit decision holding HMO denials of Medicare services to be state action subject to the Due Process Clause.

iii. Private Prisons.—Both the federal and state governments have begun contracting with private actors to provide more contro-

123. See Boese, supra note 103, at 59-62. Patients with grievances about managed care plans have little recourse because the Employee Retirement Income Security Act (ERISA) preempts most of their legal claims and limits them to an ERISA appeals process under which they may recover only wrongfully denied benefits and attorney’s fees. See id. at 59-60. Boese’s article examines the growth of qui tam actions brought pursuant to the Federal False Claims Act as a mechanism for disgruntled patients to sue managed care organizations for substandard care, underutilization of health care services, and violations of federal regulations. See id. at 60-62. Courts have grown more receptive to patient attempts to sue MCOs in negligence and wrongful death actions. See Robert Pear, Series of Rulings Eases Constraints on Suing HMO’s, N.Y. TIMES, Aug. 15, 1999, at A1.

124. For an overview of consumers’ procedural rights under both Medicare and Medicaid, see Kinney, supra note 26, at 67-73.

125. Two leading reports on the BBA seem unduly optimistic about this possibility. See 1 SARA ROSENBAUM ET AL., GEORGE WASHINGTON UNIV. MED. CTR., NEGOTIATING THE NEW HEALTH SYSTEM: A NATIONWIDE STUDY OF MEDICAID MANAGED CARE CONTRACTS (3rd ed. 1999), http://www.gwu.edu/~chsrp/MANGA (last visited Apr. 7, 2000) (text accompanying notes 39-40); ANDY SCHNEIDER, THE KAISER COMM’N ON THE FUTURE OF MEDICAID, OVERVIEW OF MEDICAID MANAGED CARE PROVISIONS IN THE BALANCED BUDGET ACT OF 1997, at 27 (1997), http://www.kff.org/content/archive/2102 (last visited Apr. 7, 2000). Both reports cite Daniels v. Wadley, 926 F. Supp. 1305 (M.D. Tenn. 1996), for the proposition that beneficiaries enjoy constitutional due process rights against MCOs. In fact, the district court’s state action finding in Daniels (itself based on a dubious reading of the Supreme Court’s state action jurisprudence) was vacated in part on appeal. See Daniels v. Menke, 145 F.3d 1330 (6th Cir. 1998) (unpublished table decision). The Kaiser report also refers to the possibility that Medicaid enrollees will enforce MCO-state agency contracts in third-party beneficiary claims, but the relevant law is mixed at best. See Perkins & Olson, supra note 121, at 33 (citing a “multitude of tests being used to determine third-party beneficiary status”).

126. See Grijalva v. Shalala, 152 F.3d 1115, 1120 (9th Cir. 1998), vacated, 526 U.S. 1096 (1999). The Court remanded the case for consideration in light of American Manufacturers Mutual Insurance Co. v. Sullivan, 526 U.S. 40, 50 (1999), which held that a private insurer’s decision, made pursuant to the state worker’s compensation statute, to suspend payment of a health benefit pending utilization review was not state action. See Grijalva v. Shalala, 526 U.S. 1096, 1096 (1999). However, the Court also instructed the Ninth Circuit to consider the Balanced Budget Act of 1997 along with HHS’ implementing regulations, which confer procedural rights upon patients. See id.; see also Balanced Budget Act of 1997, Pub. L. No. 105-33, §§ 4001-4002, 111 Stat. 251, 275-327. The Ninth Circuit in Grijalva had distinguished Blum v. Yaretsky, 457 U.S. 991 (1982), and reasoned that HMOs and the federal government were joint participants in the Medicare provision. See Grijalva, 152 F.3d at 1120.
versal functions, such as incarceration.\textsuperscript{127} The Federal Bureau of Prisons and a variety of state corrections departments currently rely on private for-profit companies to house a small percentage of the nation’s inmates.\textsuperscript{128} Today, at least thirty-four states plus Puerto Rico have passed enabling statutes legalizing the delegation of prison operations to private firms.\textsuperscript{129} Like advocates of privatization in other contexts, proponents of private prison management claim that privatization will increase both efficiency and quality: Motivated by profit and unburdened by civil service employment constraints, private companies promise to build prisons more quickly and at lower cost than can public agencies.\textsuperscript{130} In an era of significant prison expansion and skyrocketing prices, privatization offers the taxpayer very attractive cost savings.

Even in publicly operated prisons, private firms provide basic goods such as food, bedding, and clothing, along with medical, rehabilitative, vocational, and transportation services. In addition, both federal and state governments contract with the private sector to build and maintain prison infrastructure, and to supply everything from bulletproof vests to security systems. And private involvement

\textsuperscript{127} See Laura Suzanne Farris, Comment, \textit{Private Jails in Oklahoma: An Unconstitutional Delegation of Legislative Authority}, 33 \textit{Tulsa L.J.} 959, 959 (1998) (noting the trend toward "privatization" and stating that 120 private jails and prisons are operating in 27 states).

\textsuperscript{128} Private prisons house less than 10% of the 1.8 million Americans currently behind bars. See Nzong Xiong, \textit{Private Prisons: A Question of Savings}, \textit{N.Y. Times}, July 13, 1997, at C5 (reporting that private prisons in the United States held more than 85,000 inmates in 1996).


\textsuperscript{130} Up to two thirds of a prison’s operating costs are personnel-related. See Kevin Acker, \textit{Off with Their Overhead: More Prison Bars for the Buck}, \textit{POLY REV.}, Fall 1999, at 73, 73.
in public correctional facilities goes beyond contracts for goods and services. So in one sense, a robust private role in public persons is not new.

Sociologists already describe corrections as a “subgovernment,” a network of organizations comprised of federal agencies, for-profit corporations, and professional associations. Nongovernmental professional groups such the American Correctional Association (ACA), an organization of correctional professionals that dates from 1870, exert considerable influence over correctional policy. The ACA performs a variety of functions that shape corrections policy, including training personnel and accrediting agencies and programs. Indeed, ACA standards govern most aspects of prison operation. Contracting out the management of prisons to for-profit companies represents a step on the continuum of “private dependence” (that is, government’s dependence on private entities to perform its functions), then, rather than a dramatic shift toward private actors.

Still, this step is a rather significant one. Prison privatization has spurred a vigorous debate in the legal, political, and policy communities and produced an enormous volume of literature. Of all the services and functions currently contracted out, incarceration appears to attract the most visceral opposition. Those who object to prison privatization reject it on moral as well as pragmatic grounds. For example, John DiIulio has argued that incarceration is so inherently public that it is immoral to privatize it.

Although private incarceration may be more troubling than contracting with private parties to deliver social services, many of the

131. J. Robert Lilly & Paul Knepper, The Corrections-Commercial Complex, 39 CRIME & DELINQ. 150, 151 (1993). The authors argue that participants in subgovernments share a close working relationship marked by cooperation and compromise and that subgovernments feature overlap between societal interest and the government bureaucracy in question. “The line between the public good and private interest becomes blurred as governmental and nongovernmental institutions become harder to distinguish.” Id. at 153.

132. See id. at 156-57.

133. Throughout its history, the ACA has fostered professionalism in prison administration through the development of standards and promoted progressive reforms such as rehabilitation. See MALCOLM M. FEELEY & EDWARD L. RUBIN, JUDICIAL POLICY MAKING AND THE MODERN STATE: HOW THE COURTS REFORMED AMERICA’S PRISONS 162-63 (1998). The ACA provides standards for security and control, food service, sanitation and hygiene, medical and health care, inmate rights, work programs, educational programs, recreational activities, library services, records, and personnel issues. See Hart et al., supra note 80, at 1149 (1997).


135. See DiIulio, Jr., supra note 74, at 155, 173, 176. For an argument that the market is not an appropriate mechanism for producing and distributing collective goods such as education and health care, see WALZER, supra note 73, at 86, 198. For an argument that prison privatization may not produce the anticipated efficiencies, see DONAHUE, supra note 2, at 160-65.
obstacles to effective oversight appear to be similar. The ultimate beneficiaries of the incarceration function—whether one considers them to be taxpayers, prisoners, or both—face considerable obstacles to meaningful oversight. The typical taxpayer encounters few opportunities or incentives to monitor conditions in prisons. Although prisoners may file suits alleging violations of their constitutional rights, and while families and prisoners' rights advocates may help to monitor conditions in prisons, the relative invisibility and low moral status of the prison population makes prisoners especially vulnerable and heightens the need for accountability.  

As with nursing homes providing health care, the private provider in this example is one step further removed than a public agency from direct accountability to the electorate. Moreover, the incarceration function, like quality health care, may be difficult to specify in contractual terms. Finally, the incarceration example raises most strikingly the problem of potential conflicts of interest between public and private goals. That is, the private interest in maximizing profits may conflict with the public interest in sound correctional policies. Private prison officials and private guards exercise discretion over every aspect of the prisoners' daily experience: meals, health care, recreation, cell conditions, transportation, work assignments, visitation, and parole. Private prison officials determine when infractions occur, impose punishments and, perhaps most significantly, make recommendations to parole boards. Their discretion affects prisoners' most fundamental liberty and security interests. Under pressure to generate profits, private prison operators could choose to lower costs by minimizing staff or hiring underqualified guards, or by providing minimally adequate but nonetheless substandard medical care.

136. For a description and historical analysis of the procedural mechanisms available to prisoners, including writs of habeas corpus, constitutional claims, and suits pursuant to the Civil Rights Act, see Feeley & Rubin, supra note 133, at 31.

137. This raises a concern about democratic accountability analogous to that voiced by Justice O'Connor in New York v. United States, 505 U.S. 144, 168-69 (1992), that citizens might be confused when they cannot identify the level of government responsible for a given policy.

138. See Michael O'Hare et al., The Privatization of Imprisonment: A Managerial Perspective, in Private Prisons and the Public Interest, supra note 73, at 112 (“Indeed, information flow, product specification, and control are the critical factors in the managerial analysis of privatization . . . .”).

139. See Field, supra note 134, at 661.
IV. REGULATORY CONTRACTS

A. Regulation as Negotiation

The contracts discussed thus far might be described as contracts for implementation of public policy, rather than its formulation. In addition, they might be characterized as contracts to deliver benefits and provide services, rather than contracts designed to implement coercive regulations. Notwithstanding that these contracts contain important regulatory features, their principal purpose is to procure a service such as waste collection or provide a valuable benefit such as government-financed health care.

Regulatory contracts are another matter. To the extent that contracts have arisen in the regulatory process, they serve as an alternative to traditional agency-directed implementation. To be sure, these contractual or quasi-contractual regulatory instruments differ significantly from the other public-private contracts discussed so far. Regulatory contracts might arise for different reasons than contracts to deliver social services or perform arguably public functions. Perhaps agencies turn to contractual regulatory instruments not for the reasons that explain contracting out generally, but simply because contracts with regulated entities appease a congress hostile to regulation, or because they pacify powerful industry groups committed to resisting regulation through legal challenge. Moreover, the piecemeal use of regulatory contract can seem less threatening to the ultimate power of the state than widespread contracting out, which some observers believe is more likely to shrink or weaken public institutions in relation to the market.

Finally, one might argue, from a traditional administrative law perspective most contractual regulatory instruments really amount to instances of agency discretion, and as such, can be relatively easily constrained. By contrast, contracting out is more difficult to control; outsourcing functions to private actors removes them from the reach of most discretion-constraining oversight tools altogether. In sum, from a traditional perspective, that regulatory contracts happen to take the form of contract makes little difference. With these instruments, the only relevant question for the administrative law scholar is whether, in resorting to contract as opposed to another mode of implementation, the agency has operated within the bounds of its lawfully delegated discretion.

And yet, emphasizing the contractual nature of these tools—and pairing them with the phenomenon of contracting out—highlights the special problems that contractual instruments of all sorts pose for accountability. This enables us to dig beneath the veneer of formal accountability, which a traditional focus on discretion fails to
penetrate. That is, where the discretion-oriented analysis demands only formal authorization for the agency's use of contractual instruments, or broad enough discretion to accommodate the agency's choice of contract, a focus on the contractual mode itself asks whether, even where lawful, the use of contract might undermine important norms and interests. Treating contractual regulatory instruments as something more than every other instance of discretion enables us to determine whether there is something especially troubling about contract as a mechanism of governance, even when the individual examples of contract differ from one another along a number of dimensions.

To date, there is no formal contractual mechanism for either establishing or implementing regulatory standards. Indeed, the notion of private contract is anathema to public regulation. And yet, to a significant extent, negotiation and exchange pervade the regulatory process. This observation is at once banal and too frequently overlooked. It is banal in the sense that it was precisely the pervasiveness of secret, informal bargains that vindicated capture theory and prompted the procedural administrative law reforms of the 1960s. These judicially imposed reforms opened the administrative process to public scrutiny and both balanced and structured private influence, developments that Richard Stewart captured so effectively in his interest representation model of administrative law.

At the same time, the full impact of negotiation and exchange has been overlooked to the extent that it pervades implementation and enforcement as well as rulemaking. Even in a command-and-control system, the regulatory process is deeply, if informally, contractual. For example, regulated entities negotiate the terms of their permits and litigants frequently settle conflicts through negotiated consent decrees. That is, the procedural reforms Professor Stewart identified were designed to structure only part of the “regime of exchange” that constitutes the regulatory process.

In fact, the conceptual distinction between contract and regulation may not be as clear as we think. Regulation does not conform to an

140. See generally CORNELIUS M. KERWIN, RULEMAKING: HOW GOVERNMENT AGENCIES WRITE LAW AND MAKE POLICY (1994) (“Negotiated rulemaking is now a mature concept with considerable, and largely positive, track record in the development of rules.”).
141. See Stewart, supra note 12, at 1760-89.
142. See id. at 1670.
143. See Geoffrey C. Hazard, Jr. & Eric W. Orts, Environmental Contracts in the United States, in ENVIRONMENTAL CONTRACTS AND REGULATORY INNOVATION: COMPARATIVE APPROACHES IN EUROPE AND THE UNITED STATES (K. Deketelaere & E. Orts eds., forthcoming 2000) (manuscript at 9-10, on file with author) (contrasting contract and regulation, but claiming that the differences are of degree rather than kind). To give just a sample of the Hazard and Orts list of comparative attributes, contracts require party assent while regulation requires party submission, and contracts involve participation in the process while regulation demands subjugation to the process. See id.
idealized hierarchical model of government power, in which agencies directly deliver services or unilaterally impose rules on regulated entities under threat of sanction. Instead, the regulatory process can be understood as a set of residual choices that must be made by regulated entities, together with government and other interested parties, after some of the choices have been ruled out. This understanding focuses attention on the space left for working out the content of the regulation and its implementation, rather than on the initial move by the state to shrink that space. At virtually every step in the regulatory process—standard setting, implementation, and enforcement—the state forecloses some options and conditions others.

Within the constrained space of permissible choices, then, negotiation is common and constant. Gerd Winter describes the implementation process as a “bartering” system in which an agency’s discretion gives it room to maneuver;¹⁴⁴ John Scholz characterizes enforcement in similar terms.¹⁴⁵ In this space, the relevant actors (governmental and nongovernmental parties) make and execute agreements and rely on each other’s promises.¹⁴⁶ Repeat players establish cultures, understandings, and norms that govern their behavior.¹⁴⁷ Their arrangements may be structured by legal entitlements, but these play a background or shadow role.

This informal system of obligation and exchange may be a staple of agency decisionmaking, but from the perspective of administrative law, it must be tracked and constrained. To prevent agencies from abusing their discretion and to avoid agency capture by regulated interests, administrative law seeks to cabin the informal space for barter, primarily, though not exclusively, through judicial review. It is in this context—one largely hostile to the notion of regulatory bargains—that experiments with regulatory contracts have nonetheless begun to emerge.

### B. Experiments in “Contractual” Regulation

While in their infancy, these experiments have developed sufficiently to merit the attention of legal scholars. Contractual regulatory instruments consist of a handful of loosely defined innovations, distinguishable from conventional approaches because they feature negotiation, bargain, and/or consensus among stakeholders, and because they usually manifest themselves in written agreements. This includes not only regulatory negotiation, but also examples like

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¹⁴⁶ See Winter, *supra* note 144, at 221-22.
¹⁴⁷ See id. at 230-32.
EPA’s Project XL and a host of other implementation and enforcement strategies that run the gamut from standard setting to implementation and enforcement, most of which have developed in environmental or health and safety regulation. For example, Caldart and Ashford recently identified a number of OSHA and EPA efforts to informally negotiate implementation and compliance with regulated entities.\textsuperscript{148} Congress has explicitly authorized some of these initiatives, while others are instances of agency enforcement discretion, as when an agency agrees not to enforce formal legal requirements in exchange for a regulated entity’s agreement to perform obligations not required by formal law. Although these agreements are not enforceable, David Dana argues that they exemplify a “contractarian” approach to regulation.\textsuperscript{149}

Regulatory negotiation—a formal consensus-based stakeholder process for developing regulations—is probably the most frequently cited example of a contract-like instrument.\textsuperscript{150} In passing the Negotiated Rulemaking Act (NRA), Congress authorized agencies to use this nontraditional method of rule development (reg-neg) when agencies believe it to be in “the public interest” after considering a number of factors, including whether the agency can convene a balanced negotiating committee capable of representing the interests that will be significantly affected by the rule.\textsuperscript{151} Reg-neg was originally intended to achieve a number of goals, including improved rule quality


and greater legitimacy for the resulting rules. Early proponents also expected that it would reduce litigation and conserve resources by bringing parties likely to challenge the rule or obstruct its implementation directly into the development process. Its innovation was to bring principles of alternative dispute resolution to rulemaking—in the form of direct negotiations among the affected parties—in order to ameliorate the adversarialism that had come to characterize the conventional approach.

Because negotiated rules must still go through the notice-and-comment process and because the convening agency is not bound to promulgate the consensus rule, reg-neg falls well short of embodying a formal contract. Still, reg-neg is a meaningful example of a contract-like mechanism. Participants in a reg-neg clearly form alliances, stake out positions, and bargain. Typically, they sign an agreement not to legally challenge any rule produced by a consensus of which they are a part. Although these agreements are unlikely to be legally enforceable, there may be a price for noncompliance, particularly for repeat players who face informal sanctions and reputational costs. At a minimum, the parties in a reg-neg clearly take their participation seriously (devoting significant time and resources to it) and they expect their consensus to form the basis of the final rule.

Beyond the rule-writing process, the implementation stage of regulation has produced a number of contract-like innovations. For example, the EPA has adopted a quasi-contractual approach to implementing environmental regulations in its Project XL initiative.


153. Although some scholars view reg-neg simply as a bargaining exercise, in my view the parties on a reg-neg committee do more than trade interests. Direct participation in rule development can enable creative problem solving, increase learning, improve relationships and, at least according to participants, facilitate rule implementation. See Freeman, supra note 151, at 26-28, 36 (explaining reg-neg as problem solving). See also Freeman & Langbein, supra note 152, at 62 (pointing to empirical evidence that participants in reg-neg report significantly more learning than participants in conventional rulemaking, view negotiated rules as likely to be successfully implemented, and report higher satisfaction partly because they obtain a higher quality rule).

154. See 5 U.S.C. § 553 (requiring notice and comment); see also USA Group Loan Servs. v. Riley, 82 F.3d 708, 714-15 (7th Cir. 1996) (holding that the promise to bargain in good faith is not enforceable under the NRA and that the agency may depart from the consensus when promulgating a rule).

155. See Freeman & Langbein, supra note 152, at 92 n.154 (citing an example of such an agreement).

156. See id. at 213 (explaining the implications of signing agreements not to sue, even if they are unenforceable). Reg-negs promulgated intact after negotiations are “remarkably resistant to substantive changes.” Philip J. Harter, Assessing the Assessors: The Actual Performance of Negotiated Rulemaking, 9 N.Y.U. ENVT. L.J. 32, 51 (2000). Harter analyzes the data provided in Coglianese’s study, supra note 151. See Harter, supra, at 49-52.
the national pilot program designed to test methods of achieving superior and more cost-effective environmental protection through project agreements with individual facilities or industry sectors.\textsuperscript{157} Through XL, the agency exercises its enforcement discretion to go one step beyond the informal negotiation that already occurs in the traditional permitting process, by granting regulatory flexibility to applicants in exchange for commitments to achieve better environmental performance than might otherwise be achieved through compliance with applicable regulations.\textsuperscript{158} The idea is to allow firms to devise innovative compliance strategies that result in a net environmental benefit in exchange for relief from rigid regulations.

In a typical XL project, the EPA might grant a single, streamlined permit that authorizes cross-pollutant and cross-media trades that might not otherwise be allowed by regulations.\textsuperscript{159} XL allows the agency to grant preapproval of process changes or emissions increases that would normally trigger a lengthy separate approval process.\textsuperscript{160} While these initiatives do not produce legally enforceable contracts, they culminate in detailed, written documents known as final project agreements (FPAs). XL thus has some contractual features: the parties bargain, they produce written agreements, and they undertake mutual commitments. The terms and conditions of the FPAs are then incorporated into permits, which are legally enforceable.\textsuperscript{161}

Habitat conservation planning is perhaps the most visible example of a consensus-based, multi-stakeholder approach to resource management, and one explicitly authorized by Congress in the Endangered Species Act (ESA).\textsuperscript{162} Under section 10(a) of the ESA, the Secretary of Interior may issue a permit to allow an otherwise impermissible “incidental take” of a threatened or endangered species, provided the applicant submits a satisfactory “conservation plan” (HCP).\textsuperscript{163} Among other things, the plan must ensure that the “take” will not “appreciably reduce the likelihood of the survival and recovery of the species involved.”


\textsuperscript{159} Cross-pollutant trades allow permit holders to produce more of one pollutant but less of another. Cross-media trades allow holders to degrade more of one medium but less of another.

\textsuperscript{160} See Susskind & Secunda, supra note 157, at 86.

\textsuperscript{161} See \textit{id}.


\textsuperscript{163} Id. § 10(a), 16 U.S.C. § 1539(a) (1994).
ery of the species in the wild." Thus, HCPs amount to mitigation measures designed to minimize the impact of a proposed action (usually a development project) on a threatened or endangered species.

Although the only truly indispensable parties in the HCP negotiation process are those whose actions may result in the taking, many HCP negotiations include a diversity of stakeholders, including community groups, environmental organizations, scientists and other experts, and nonprofit land conservation groups. As with regulatory negotiation, the federal agency (here the Fish and Wildlife Service) participates in the negotiations but is also statutorily obligated to independently determine the adequacy of the plan, submit the plan to public comment, and then decide whether to issue the permit.

J.B. Ruhl describes HCP agreements as “quasi-contractual” even though they are incorporated into permits. The permitting process itself is “a structured negotiation” in which the applicant negotiates with the agency to design a “development scenario that is compatible with the conservation goals of the ESA as well as the economic goals of development in general.”

Reinforcing the “contractual” image of the HCP process, the Fish and Wildlife Service recently adopted a “no surprise” policy by regulation. The policy assures HCP permittees that the agency will impose no additional burdens on them in the event of changed circumstances.

A contractual approach is currently built into the agency enforcement process as well, in the form of “supplemental enforcement plans” (SEPs) by which agencies waive monetary penalties in exchange for remedial measures to which the regulated entity may not otherwise submit. Proponents of this enforcement innovation argue that SEPs are more problem oriented than conventional penalty assessment; they claim that SEPs provide both short- and long-term benefits.

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164. Id. § 10(a), 16 U.S.C. § 1539(a)(2)(B)(iv). The requirements of section 10(a) largely mirror the contents of the San Bruno HCP, which had been developed independently in response to a conflict between proposed development and the habitat of a threatened butterfly species. The plan was developed by the parties without specific ESA authorization. The parties subsequently urged Congress to amend the ESA to allow a permitting exemption based on the plan. The San Bruno HCP was formally accepted by the Department of the Interior and a permit was issued following passage of the 1982 amendments. See Endangered Species Act Amendments of 1982, Pub. L. No. 97-304, 96 Stat. 1411; Robert D. Thornton, Searching for Consensus and Predictability: Habitat Conservation Planning Under the Endangered Species Act of 1973, 21 ENVTL. L. 605, 624-26 (1991).

165. See Thornton, supra note 164, at 625.


168. Id.

benefits by enabling firms to identify opportunities for technological change that might have additional beneficial environmental effects beyond the immediate lawsuit.\textsuperscript{170}

For the most part, however, environmental contracting is in an early developmental phase. To take effect, most such agreements still require independent agency action such as rule promulgation or permit issuance, and most purport to be independently unenforceable.\textsuperscript{171} Still, both Congress and individual agencies appear willing to experiment with regulatory contracts, and a handful of scholars find them promising enough to pursue as an alternative approach.\textsuperscript{172} For example, Don Elliott has proposed that “command and covenant” might replace command-and-control regulation.\textsuperscript{173} Based on an XL-like approach, this model would rely on a government-established minimum standard of performance, while allowing regulated entities to essentially contract around regulatory inefficiencies by devising implementation strategies. Dan Farber recently described efforts such as reg-neg and Project XL as illustrations of a bilateral bargaining model of regulation, and he suggested that it seems the “most promising” way to conceptualize regulation.\textsuperscript{174}

\textsuperscript{170} See Caldart & Ashford, supra note 148, at 191 (citing an EPA report claiming that company representatives credited the SEP process with this benefit). After analyzing the kinds of technological changes prompted by the settlements, Caldart and Ashford claim that there remain unexploited opportunities for using the enforcement process to stimulate technological change. See id.

\textsuperscript{171} For example, Project XL Final Project Agreements state that they are unenforceable. Parties can withdraw from them at any time and revert to the default system of regulation. See Susskind & Secunda, supra note 157, at 85-86.

\textsuperscript{172} See Hazard & Orts, supra note 143 (manuscript at 30). In an effort to illuminate the already frequent use of legally enforceable contract in regulation, Orts and Hazard cite the pervasive ness of settlement agreements that may amount to a kind of contractual regulation by litigation. For example, settlement agreements of environmental disputes may end up governing complex regulatory matters involving multiple parties, such as the manner and extent of remediation of hazardous waste sites that qualify for cleanup under the Superfund statute. See id. (manuscript at 1-2).


\textsuperscript{174} Daniel A. Farber, Triangulating the Future of Reinvention: Three Emerging Models of Environmental Protection, 2000 U. I.L.L. L. REV. 61, 61, 76-77. Farber proposes a “bilateral bargaining” model and compares it to alternatives, including a “governance” model, which is multilateral and ecosystem-based. Id. at 62; see also Caldart & Ashford, supra note 148, at 199-202. See generally Freeman, supra note 151, at 4-6 (proposing a collaborative model of regulation in which negotiation and problem solving play a prominent role). Farber was careful, however, to cite the problems associated with the bargaining model. See Farber, supra, at 117-18; See also Mark Seidenfeld, Empowering Stakeholders: Limits on Collaboration as the Basis for Flexible Regulation, 41 WM. & MARY L. REV. 411, 412-13 (2000).

Another process that fits within a broadly defined contractual approach is the Common Sense Initiative (CSI). See U.S. GENERAL ACCOUNTING OFFICE, REGULATORY REINVENTION: EPA’S COMMON SENSE INITIATIVE NEEDS AN IMPROVED OPERATING FRAMEWORK AND PROGRESS MEASURES 1 (1997). CSI is an effort to devise superior regulatory strategies in six important industrial sectors by bringing the relevant stakeholders to-
Moreover, although a contractual regulatory model is new to the United States, enforceable contracts are an increasingly common feature of environmental regulation in the European Union. In Belgium, the Netherlands, France, and Germany, a variety of contractual instruments have emerged, including “agreements” or “covenants” between governments and industrial polluters, as well as agreements between polluters and local communities. Some of these instruments are considered “voluntary” and unenforceable but nonetheless replace procedural requirements and regulatory commitments; others have the status of legally enforceable contracts. Citing the European experience—and mindful of potential conflicts between the government’s role as sovereign and its role as contracting party—Geoff Hazard and Eric Orts recently suggested that we explore the potential of contract in American regulation.

One need not look to Europe, however, for examples of hybrid instruments that combine regulation and contract. Local land use regulation presents a precedent for the theory and practice of regulatory contracting. Through contract zoning and development agreements, local government bodies routinely bargain with private developers and residents and reach legally enforceable agreements that contain, among other things, regulatory freezes and exactions. This form of government action is neither regulatory in a traditional sense nor conventionally contractual: it depends on a convergence of regulatory and contract power.

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175. See generally Eric W. Orts & Kurt Deketelaere, Introduction: Environmental Contracts and Regulatory Innovation, in ENVIRONMENTAL CONTRACTS AND REGULATORY FUNCTIONS, supra note 143 (manuscript at 5).

176. See id.

177. See id. at 7 (comparing German “self-commitments” to Dutch civil contracts).

178. See Hazard & Orts, supra note 143 (manuscript at 4-5).

179. See Carol M. Rose, Planning and Dealing: Piecemeal Land Controls as a Problem of Local Legitimacy, 71 CAL. L. REV. 837, 892 (1983). Rose suggests that courts approach land use deals not by classifying the government mode in terms of traditional categories of governmental action, but by using this mediation theory. She argues that they ought to assess the legitimacy of land use deals by analyzing “whether the local body went through the steps of identifying disputants, exploring issues, and explaining results.” Id. at 900.
C. Objections to Regulatory Contracts

1. The “Undemocratic” Critique

Traditionally, we view regulation as a top-down and prescriptive exercise consisting of government-imposed requirements or outright prohibitions that regulated entities must observe upon pain of civil and criminal penalty. Establishing and enforcing regulatory standards is legally and culturally understood to be the state’s responsibility. In a democratic system, we expect our elected representatives to be accountable for state-sponsored coercion. Although Congress might delegate the bulk of the regulatory task to administrative agencies, agency discretion is constrained by numerous formal and informal accountability mechanisms, including legislative and executive oversight, judicial review, procedural rules, and media scrutiny. To the extent that agencies further delegate coercive regulatory tasks to private actors, we expect the delegates to be adequately constrained by, for example, mandatory procedures and rigorous agency oversight. If private actors are permitted to share standard-setting authority or assume the enforcement responsibility that lies first and foremost with the agency, we expect there to be significant limits on their authority.

Although most administrative law scholars would surely acknowledge that informal negotiation, bargaining, and exchange pervade the regulatory process, none of the several competing theories of administrative law advances the normative claim that regulation ought

180. The notion that lawmaking is the obligation of the state is rooted in Article I of the Constitution and expressed in the nondelegation doctrine. Although individual members of the Supreme Court occasionally threaten to invoke the nondelegation doctrine, the doctrine has not been applied meaningfully since 1935. Nonetheless, it remains a background threat that may serve to discipline agency officials’ interpretation of their statutes. However, the D.C. Circuit recently invoked the nondelegation doctrine, and in an unconventional way, in striking down EPA’s revised ambient air quality standards for ozone and particulate matter established pursuant to the Clean Air Act. See American Trucking Ass’ns v. EPA, 175 F.3d 1027 (D.C. Cir. 1999), modified on reh’g, 195 F.3d 4 (D.C. Cir. 1999). [Editor’s Note: On February 27, 2001, the Supreme Court reversed American Trucking as to the nondelegation issue. Whitman v. American Trucking Ass’ns, 121 S. Ct. 903, 911-14 (2001).] For references to the nondelegation doctrine in recent Supreme Court opinions, see Clinton v. City of New York, 524 U.S. 417 (1998) (invalidating line item veto); and Industrial Union Dep’t v. American Petroleum Inst., 448 U.S. 607, 685-88 (1980) (Rehnquist, J., concurring, on nondelegation grounds).

181. See Harold I. Abramson, A Fifth Branch of Government: The Private Regulators and Their Constitutionality, 16 HASTINGS CONST. L.Q. 165, 181-86 (1989); Barry Boyer & Errol Meidinger, Privatizing Regulatory Enforcement: A Preliminary Assessment of Citizen Suits Under Federal Environmental Laws, 34 BUFF. L. REV. 833, 838-40 (1985) (referring to the effort that citizen enforcement groups had to expend gaining credibility and legitimacy as enforcers); Harold J. Krent, Fragmenting the Unitary Executive: Congressional Delegations of Administrative Authority Outside the Federal Government, 85 NW. U. L. REV. 62, 70, 95-96 (1990); Stewart, supra note 12, at 679 (arguing that citizen enforcement by narrow issue groups may create more problems than they were designed to solve).
to be the product of explicit contracting between agencies and stakeholders. Indeed, two of the dominant theories (public interest and civic republicanism) would affirmatively reject such a proposal as enabling government to abdicate its role, and a third (interest representation) advocates procedural reforms that would structure the political process without presumably allowing it to devolve into explicit contracts. For most commentators, the pursuit of contractual regulation would be fundamentally undemocratic, particularly if agencies experimented with it under the guise of their enforcement discretion without explicit authorization by Congress. Even when Congress approves it, however, contractual regulation attracts considerable criticism. A move to contract may prove simply implausible in a political culture historically intolerant of all things corporatist.

The debate over regulatory negotiation provides a case in point. A number of commentators object to reg-neg on the theory that it encourages the convening agency to abdicate its responsibility for implementing congressional intent. One commentator asserts that “the principles, theory, and practice of negotiated rulemaking subtly subvert the basic, underlying concepts of American administrative law.” In this view, regulation requires an authoritative decision maker, while contract reduces the agency to a negotiating partner. Conceptually, the two are mutually exclusive.

2. Ousting Public Law Norms

For some, contractual approaches to regulation might be objectionable because they “oust” public norms in favor of private ones. Processes like reg-neg and Project XL seem to prioritize the satisfaction of the immediate parties over satisfaction of the “public interest” (however loosely defined) by, say, elevating the importance of reach-

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182. In its description of the legislative and bureaucratic process, public choice theory seems most compatible with a view of regulation as de facto contractual, and yet, public choice scholars tend to shy away from normative prescriptions. Moreover, only a minority of public choice scholars are self-consciously normative, and when they are, they typically advocate deregulation. See, e.g., ANDREI SHELEIFER & ROBERT W. VISHNY, THE GRABBING HAND 3-5 (1998) (claiming that the premise of the “grabbing hand” approach is that government control of economic activity is itself the fundamental problem).


184. On the other hand, there is certainly precedent for peak-level negotiations among interest groups resulting in enforceable bargains—one need only look to the history of collective bargaining in labor law.

185. See, e.g., Coglianese, supra note 151, at 1334-37 (questioning the perceived ability of reg-negs to limit delays and conflicts in the regulatory process); Susan Rose-Ackerman, American Administrative Law Under Siege: Is Germany a Model?, 107 HARV. L. REV. 1279, 1281 (1994) (claiming that regulatory negotiation is “inadequate if one accepts [a] basic commitment to . . . the democratic legitimacy of the administrative process”).

186. Funk, supra note 151, at 1356.
ing consensus over other values that the median voter or average consumer might care about (such as the stringency of a health or safety standard or the speed of its implementation). One might also argue that contractual approaches deprive the courts of opportunities for adjudication by settling important matters of public policy privately. This charge—that the “privatization” of decisionmaking deprives a democratic society of the norm-articulating function of judicial decisions—has been leveled frequently at both alternative dispute resolution as a means of settling civil suits and at settlement in general, but it applies equally, and perhaps more potently, to public policy decisions normally made by government agencies.\(^{187}\)

Recall for example, that parties in a regulatory negotiation commit, as a condition of participation, not to challenge the consensus rule. If a significant percentage of rules were produced this way, courts might lose their critical role in protecting and advancing, through review of agency decisionmaking, the public policy articulated in regulations. This could deprive the public of a check on the agency’s interpretation of its delegated authority, affording courts fewer opportunities to weigh in on the meaning of statutes.\(^{188}\)

In this view then, a process like regulatory negotiation co-opts the agency: the agency outsources its regulatory responsibility to stakeholders that make deals to serve their interests, which the agency then promulgates and defends in the form of final rules. While the potential for reg-neg to reduce the risk of legal challenge might be a prized benefit for its fans, to critics it simply means that rulemaking—an already opaque process to the average person—gets driven further underground. In this vein one might argue that with a rate of legal challenge for conventionally developed rules hovering between

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187. This concern surfaces frequently as a criticism of alternative dispute resolution (ADR) and as the reason for judicial reluctance to enforce arbitration agreements. See, e.g., 1 RICHARD L. ABEL ET AL., THE POLITICS OF INFORMAL JUSTICE: THE AMERICAN EXPERIENCE (Richard L. Abel ed., 1982); Owen M. Fiss, Against Settlement, 93 YALE L.J. 1073 (1984); David Luban, Settlements and the Erosion of the Public Realm, 83 GEO. L.J. 2619, 2622-25 (1995); see also Edward Brunet, Questioning the Validity of Alternative Dispute Resolution, 62 Tul. L. Rev. 1, 19-21 (1987) (arguing that conventional litigation should be viewed as a public good and that litigation offers benefits to third parties, such as written opinions to guide future behavior); G. Richard Shell, ERISA and Other Federal Employment Statutes: When Is Commercial Arbitration an “Adequate Substitute” for the Courts?, 68 Tex. L. Rev. 509, 517, 566-69 (1990) (describing mandatory ADR in employment law and the loss of Title VII claims in terms of a loss of “public value” articulation by courts).

188. Scholars have made a similar argument about the rise of judicial decisionmaking without publishing reasons. See Mitu Gulati & C.M.A. McCauliff, On Not Making Law, LAW & CONTEMP. PROBS., Summer 1998, at 157. “The failure to write and publish an opinion deprives the system of the many positive externalities created when a case is decided by a published opinion that gives reasons.” Id. at 175. Of course, most regulations are never challenged and subjected to judicial review. This could cut either for or against the argument that more negotiated rules would meaningfully undermine the articulation of public norms.
twenty-five and thirty-five percent, the rulemaking process may not be “ossified” enough. Further reducing litigation would remove an important check on bureaucratic decisionmaking.

The complaint about “ouster” is reminiscent of capture theory and resonates with the public choice account of the legislative and bureaucratic process. Although negotiation has always characterized the regulatory process, it was precisely the fear that informal deals were subverting the public interest that motivated the procedural reform of agency process during the sixties and seventies. Critics thus view the embrace of negotiation, and presumably enforceable regulatory contracts of all kinds, as, at best, a romantic and misguided enterprise, and at worst a naked power grab by well-financed repeat players.

V. CONTRACT AS AN ACCOUNTABILITY MECHANISM

Thus, all of the contractual examples discussed thus far, whether contracts to provide services or perform functions of regulatory contracts, engender considerable opposition for a variety of reasons. Extensive contracting out poses significant contractual design challenges, enables government to avoid constitutional scrutiny through delegation and may, in at least some circumstances, be viewed as incompatible with liberal democratic principles. In addition, contracting out may disempower third-party beneficiaries who enjoy few rights of participation in a privately controlled decisionmaking process. Finally, widespread contracting out may weaken both Congress and the executive branch by diffusing power so effectively as to impede monitoring and supervision, while simultaneously burdening the judiciary with appeals for third-party beneficiary rights of action and demands for judicial review of contract validity. This will force courts to wrestle with a potentially uncomfortable convergence of public and private law. Like contracts to perform functions or provide services, regulatory contracts also present drafting and technical design challenges and in some cases allow agencies to “abdicate” regulatory responsibility. These contracts may also increase the burden on the judiciary. In particular, courts will need to reconcile contract principles of interpretation with administrative law principles of deference.

Despite posing considerable cause for concern, contractual instruments also represent potentially useful accountability instruments. Conceivably, public-private contracts could function not only as mechanisms for delivering social services or effecting regulatory purposes, but as vehicles for achieving public law values, such as

fairness, openness, and accountability. Contracts themselves might do more work as enforceable agreements. Provider contracts could equip agencies with more effective enforcement tools. In the nursing home context, for example, greater specificity of terms, graduated penalties, and oversight by a “contract manager” employed by the agency might help agencies to oversee quality of care. Indeed, trends point in this direction. Recent reforms in the nursing home context have put a greater variety of enforcement tools at government’s disposal.

Contracts could also require private homes to observe minimal administrative procedures such as notice and hearing requirements, which might help to eradicate the most arbitrary decisions and slow the pace of others. Given legitimate fears about lax government enforcement, contracts could go farther still by conferring explicitly upon patients third-party beneficiary rights that would allow consumers to sue when government monitoring failed. In addition to these traditional measures, contracts could be instruments for diversifying sources of oversight. For example, a contract could establish an ombudsman to represent nursing home residents, or it could demand that nursing homes submit to periodic review by a community oversight committee.

Contracts could help to provide accountability in the Medicaid managed care context as well. As major and growing purchasers of care, states will soon be in a position to drive demand for NCQA accreditation of MCOs. States could require by contract that MCOs

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190. Courts adjudicate disputes over payment, withdrawal from a program, or any other matter arising within the agency-provider relationship on principles of contract law. See Elias S. Cohen, Legislative and Educational Alternatives to a Judicial Remedy for the Transfer Trauma Dilemma, 11 AM. J.L. & MED. 405, 418 (1986) (summarizing three federal cases involving voluntary withdrawal from Medicaid provider and noting that these types of cases turn on the issue of contractual relationship between the state agency and provider).

191. See Health Care Fin. Admin., supra note 90.

192. Some state statutes and judicial decisions have recognized private rights of action to enforce state licensure laws in the context of nursing homes. See Kinney, supra note 26, at 68 n.147 citing SANDRA H. JOHNSON ET AL., NURSING HOMES AND THE LAW: STATE REGULATION AND PRIVATE LITIGATION §§ 1-21 to 1-28 (1985); see also Smith v. Heckler, 747 F.2d 583 (10th Cir. 1984) (holding in a class action suit that the HHS Secretary had violated the Medicaid Act by not informing herself as to whether facilities receiving federal money satisfied federal requirements).

193. Indeed, third-party oversight by either family members of residents or community groups already seems to be a crucial ingredient in the quality of nursing home care. Community interest and concern is the single most important reason why small and rural nursing homes have the best reputations for high quality of care. Community groups that support nursing home residents have organized across the country. See Butler, supra note 26, at 1377.

194. “State and local governments spend about 45% of the total health care purchasing dollars. Public purchasers, with their enormous purchasing power and their regulatory authority over those from whom they purchase health care, have the potential to drive the market in health care.” CAREN GINSBERG, ACADEMY FOR HEALTH SERVS. & HEALTH
diversify the providers they include in their provider networks. By demanding as a condition of the contract that MCOs include traditionally public health agencies as providers, states could introduce a quality benchmark for private providers, who may be less familiar with the vulnerable Medicaid population and may need to develop new methodologies and criteria for evaluating the sufficiency of their care. And although the transition to managed care may initially overwhelm state agencies, many states appear to be adapting to the new regime by developing model contracts.

Today, the length and detail of provider contracts varies across states, but there is a notable trend toward both detailed standards and diversification of penalties. Even relatively short provider contracts, those that simply regurgitate federal and state Medicaid law, extend federal and state regulations to private providers. As a result, they could enable government agencies to monitor quality, as well as control fraudulent claims. Some states now employ contract managers to monitor state contracts with MCOs; California recently created a state department of managed care. The contracts themselves could constitute crucial accountability mechanisms, enabling state agencies to demand submission to independent third-party oversight, private accreditation, and insurance requirements, among other things. Contracts might thus serve as a means of enlisting ad-

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POLICY, IN PURSUIT OF VALUE: INNOVATIVE STATE/MEDICAID PURCHASING STRATEGIES 3 (State Initiatives in Health Care Reform Monograph/Memoranda No. 41, 1997). According to another report, federal funds constitute 57% of all funds flowing to MCOs. See SCHNEIDER, supra note 125, at 17, http://www.kff.org/content/archive/2102. In addition to relying on commercial standards of quality, some states “piggyback” on state insurance regulators to certify financial solvency of MCOs and on private accreditors to certify the quality of the institutions’ clinical standards of care. See Interview with Sharon Connors, supra note 122.

195. See Perkins & Olson, supra note 121, at 22.

196. See NEGOTIATING THE NEW HEALTH SYSTEM, supra note 112 (reviewing variety of state contracts and noting trend toward larger and more complex contracts), http://www.gwumc.edu/chpr/overview/overview.htm.

197. Although some contracts appear to be relatively short (eight pages in Massachusetts, for example) others contain extremely detailed provisions. See id.


199. Legislation establishing California’s Department of Managed Care (DMC) came into effect on January 1, 2000, and the DMC is scheduled to become operative by July 1, 2000. The DMC will regulate all MCOs, and not just those relevant to Medicaid managed care. See California Dep’t of Managed Care, at http://www.dmc.ca.gov/library/lawregs/knox-keene/1999/assembly/ab78.asp (visited Oct. 2, 2000). Other states have adopted different institutional reforms. For example, in Ohio the Bureau of Managed Health Care (BMHC) within the Ohio Department of Human Services is responsible for the administration of the Ohio Medicaid managed care program. See Medicaid Managed Care Program, at http://www.state.oh.us/odjfs/ohp/managed.stm (visited Oct. 2, 2000). Its responsibilities include monitoring the quality of, access to, and performance of managed health care plans. See Ohio Dep’t of Job & Family Servs., Bureau of Managed Health Care, at http://www.state.oh.us/odjfs/ohp/bmhc (visited Oct. 2, 2000).
ditional nongovernmental entities such as community groups and patient advocates to provide accountability.\textsuperscript{200}

For example, Wisconsin has embarked on a Medicaid managed care program which one commentator described as “built on contracts” between the state Medicaid administrator, MCOs, communities, public health organizations, and consumer groups.\textsuperscript{201} Exercising its power as purchaser, the agency “encourages MCOs to utilize community groups, public health units, and schools” to provide care,\textsuperscript{202} and these commitments are reflected in formal agreements.\textsuperscript{203} Among other things, the agreements provide for HMO advocates to represent patients and coordinate activity with community coalitions.\textsuperscript{204} Similarly, the state Medicaid agency in Massachusetts has developed a “customer advisory committee” to represent the populations served by each of their benefit plans.\textsuperscript{205} Thus, there are opportunities for fostering accountability through a combination of contractual, organizational, and market-based mechanisms.

The prison context presents equally significant opportunities for contract to help provide accountability. The already powerful presence of private standard setting, for example, could be further exploited through contract. States could require compliance with both procedural and substantive standards that might otherwise be inapplicable or unenforceable against private providers.\textsuperscript{206} The model contract for private prison management drafted by the Texas Department of Criminal Justice (TDCJ) demands, for example, that contractors comply with constitutional, federal, state, and private standards, including those established by the American Correctional Association

\textsuperscript{200} Again, the devolution of welfare reform offers a useful analogue. Although welfare “privatization” could cut costs and improve service delivery, we might also be concerned that states will avoid responsibility for cutting welfare rolls by shifting blame to private actors. Resorting to traditional constraints, one could argue that private parties ought to be considered “state actors” when they administer benefits or, instead, seek to invalidate delegations of power to them. See Kennedy, supra note 31, at 283-85 (applying the balancing test used in \textit{Mathews v. Eldridge}, 424 U.S. 319, 334-35 (1976), and arguing that government interest is minimized where the cost of adding procedure falls to private contractors). Given current state action doctrine, these efforts will likely prove fruitless or achieve only minimal due process protections. Again, however, the contractual mechanisms themselves could present opportunities for structuring the public-private arrangement. Contracts could require private companies to retain professional social workers, for example. Contracts, speculatively, could enable alliances to develop among private companies, professional groups, and poverty advocates.


\textsuperscript{202} Id.

\textsuperscript{203} See id. at 145.

\textsuperscript{204} Advocates are often licensed health care professionals. See id.

\textsuperscript{205} See GINSBERG, supra note 194, at 9.

CONTRACTING STATE

(ACA) and the National Commission of Correctional Health Care Standards. Contractors must certify that training provided to personnel is equal to that for state employees, and they must meet numerous performance standards concerning security, meals, and education.

The model contract states, among other things, that the contractor shall “continually conduct self-monitoring, utilizing a comprehensive self-monitoring plan approved by TDCJ.” This is equivalent to requiring a company to adopt a significant management reform. The contract also requires that private contractors establish performance measures for rehabilitative programs and develop a system to assess achievement and outcomes. State governments could also make mandatory disclosure a contractual term, requiring private contractors to publish statistics on inmate graduation from training or rehabilitation programs, or rates of illness or recidivism.

In addition, the contractor must attain and maintain ACA accreditation within eighteen months of commencement. Throughout its history the ACA has fostered professionalism in prison administration through the development of standards and promoted progressive reforms such as rehabilitation. ACA standards govern most aspects of prison operation—including security and control, food service, sanitation and hygiene, medical and health care, inmate rights, work programs, educational programs, recreational activities, library services, records, and personnel issues—and they are typi-


208. See id. at 12 (stating employees must be trained pursuant to TDCJ training requirements).

209. See id. at 12, 15, 18 (setting forth standards for security, meals, and education, respectively). The contract contains specifications for education, see id. at 32 (requiring, among other things, a 65% pass rate for GED); vocational training, see id. ex. J.6, at 86 (mandating that 20% of offender population be enrolled in and attend vocational training); and even the books in the library, see id. at 25-26 (specifying percentages of different types).

210. Id. at 45.


212. See Texas Model Contract, supra note 207, at 46.

213. See FEELEY & RUBIN, supra note 133, at 163.
cally more demanding than state or federal requirements. By requiring compliance with ACA standards, the state relies, in part, on another private actor to help ensure that contractors fulfill their obligations.

The model contract also requires contractors to carry insurance for up to $2 million per incident and $5 million per year for civil rights liability in addition to worker’s compensation insurance. It further stipulates the minimal rating for the insurers. It requires contractors to disclose all parties with a substantial interest in the proposal, presumably in an effort to surface conflicts of interest.

The contract also provides for inspection authority, access to records, and entry to the facility at any time. TDCJ may terminate contracts for a variety of reasons, including any material failure to comply with any covenant, condition, agreement, or TDCJ policy. TDCJ’s remedies for the contractor’s breach are extensive, but the contractor’s sole remedy for TDCJ’s breach is payment for services furnished.

Finally, although all contract changes must be mutually agreed upon, the contract authorizes TDCJ to unilaterally amend the terms when “judicial decisions, settlement agreements, statutes, regulations, rules and decisions of federal and state courts and governing agencies require changes or amendments” to the contract.

Finally, these contracts could also facilitate third-party participation in oversight by requiring independent monitoring or auditing of prisons by certified professionals. They might enlist the help of independent prisoners’ rights groups by granting them standing to sue for violations of any contractual terms.

Clearly, absent enforcement, the mere existence of these detailed provisions offers little assurance of accountability. And admittedly, many provisions leave considerable room for interpretation, as does the description of the limited situations in which the personnel may use force to subdue prisoners. Nonetheless, the contract presents

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214. See Hart et al., supra note 80, at 1149. Although not dispositive, compliance with ACA standards may also help private firms defend against litigation under 42 U.S.C. § 1983. Federal courts have relied on compliance with ACA standards as an indication of the acceptability of prison conditions. See PERLEY & RUBIN, supra note 133, at 163. In the prison reform cases of the 1960s and 1970s, the ACA manual became a "leading resource" for federal courts. Id. at 163, citing Judge Henley’s ruling in Holt v. Sarver, 309 F. Supp. 362 (E.D. Ark. 1970), which addresses all of the issues in the manual and incorporates many of its standards.


216. See id. at 62.

217. See id. at 68.

218. Id.

219. Such contracts may already be a source of third-party beneficiary rights. See Owens v. Haas, 601 F.2d 1242, 1250-51 (2d Cir. 1979) (holding that a federal prisoner benefiting from a contract between the federal government and Nassau County may sue under the contract).

220. See Texas Model Contract, supra note 207, at 45.
an opportunity for TDCJ to regulate contractors very extensively and to demand compliance with standards that even government facilities may not meet. Moreover, the terms appear favorable to the agency and do not seem to undermine its concurrent regulatory authority over the contractor. Whether the agency’s interpretations of contractual terms will receive the deference they would receive were they regulations, however, remains to be seen.

Regulatory contracts may represent an equally potent instrument of accountability under the right conditions. Recall that reg-neg, Project XL, and the HCP process all conform to requirements of openness and balanced representation. These provide access to a variety of stakeholders, including community groups, experts, nonprofit organizations, and issue organizations. They also force parties to commit their agreements to writing, which not only serves as a disclosure mechanism but as a potential monitoring device as well. Permits, plans, and project agreements are accessible to third-party watchdogs, who might help to oversee compliance with their terms.

Regulatory contracting might also enable agencies to extend their influence. Rather than weakening agencies, then, contracts may be instruments of strength. Within their enforcement discretion, or under the direction of Congress, agencies might strike covenants with regulated entities in which they trade flexibility for commitments not mandated by legislation or regulation—hardly a new idea, given that agencies already do this via settlement. This extended reach is only possible where parties can prioritize and trade interests, as they can when negotiating consensus rules, Project XL Agreements, HCPs, and SEPs.

VI. THE UNCOMFORTABLE INTERFACE OF PUBLIC LAW NORMS AND PRIVATE LAW PRINCIPLES

Although the service provision and regulatory contexts differ in important ways, the use of contract in both settings raises significant technical, conceptual, and doctrinal problems. Both public-private service contracts and regulatory contracts force an uncomfortable interface between public law notions of deference to agency action and private law principles of contract interpretation. The question is how to adapt the law of contract to contexts in which government acts in both a regulatory and a contractual capacity at the same time. From a traditional administrative law perspective, contractual relationships between public and private actors might undermine agency au-

221. See Freeman, supra note 151, at 36-57 (describing the reg-neg and XL convening processes).
222. See, e.g., Rich Vision Centers, Inc. v. Board of Medical Exam’rs, 144 Cal. App. 3d 110 (1983) (holding that an agency’s authority to settle disputes was implicitly authorized by statute).
authority and alter prevailing conceptions of judicial deference to agency action. Courts may not accord agencies deference in contract interpretation, nor might they permit agencies unilaterally to amend terms as they might regulations. Agencies could presumably avoid these difficulties by promulgating contracts as regulations in order to recapture the deference they might otherwise lose, or negotiate only short-term contracts, obviating the need to incorporate them as regulations. But these procedures would encumber and rigidify a more flexible contracting process, perhaps undermining some of the benefits of contracting with private parties.

Courts have struggled with the conflict between government as regulator and government as contractor, drawing sharp lines between the two. They have consistently approached government’s use of contract by categorizing the nature of the government intervention as either regulatory or contractual and according the government deference when it acts in its regulatory capacity. In the procurement context, for example, where government seems to act most like a private purchaser, judicial interpretation nonetheless typically works to the benefit of government. Even when agencies do not insert termination-for-convenience clauses in federal procurement contracts, courts imply them. When agencies do insert them, courts treat such clauses as instances of agency discretion, and they defer.223

Experiments with regulatory contract highlight the problems that arise when agencies act as both regulators and contractors. Experience with reg-neg, Project XL, habitat conservation plans, and the like suggests that agencies do act in more than one mode simultaneously. In these contexts, agencies set default rules, foster cooperation, muster credible threats, and monitor performance, but they must also bargain, make deals, and keep their word. Although these roles need not conflict, at times they will, and the prevailing theories of administrative law do not adequately account for them or explore the extent to which they may be compatible or incompatible.224

Courts currently appear reluctant to bind agencies to their regulatory agreements with private stakeholders. In USA Group Loan Services v. Riley,225 the only appellate case reviewing a negotiated rule,

224. Not surprisingly, agencies currently appear confused over how to mediate between these very different roles. Consider regulatory negotiation: The agency’s participation puts it in the awkward position of being asked to essentially preapprove tentative agreements when it is required to provide public comment periods and perform internal review before approval can be given. The agency is always constrained from participating in a negotiation as an equal. Thus, the agency finds itself having to indicate which outcomes would be acceptable without compromising its ultimate authority to alter its position on the deal should political winds change or the formal comment period turn up anticipated problems with the proposed rule. See generally Freeman, supra note 151, at 83-96; Coglianese, supra note 151, at 1322-26.
225. 82 F.3d 708 (7th Cir. 1996).
the Seventh Circuit held that the promise to bargain in good faith is not enforceable under the NRA and that the agency may depart from the consensus when promulgating the rule. The Court expressed concern that to hold otherwise would allow the agency to abdicate its responsibility for rulemaking.

However, if contract emerges as an important regulatory instrument, courts will wrestle regularly with these matters, as litigants press for assurances that government cannot simply renge at will. If a government agency fails to perform its contractual obligations, either because the responsible agency changes its mind or because another agency’s decision renders performance impossible or because Congress subsequently reverses an agency’s decision, should the government be liable for breach? And if so, what is the appropriate measure of damages? This question has arisen in Contracts Clause jurisprudence involving state governments’ breach of their contracts with private parties, as well as in zoning and development decisions involving local government, but there is a relative dearth of judicial guidance on the federal government’s obligations when it contracts with private parties. Recently, however, the Supreme Court signaled a new willingness to hold government liable for breach.

In United States v. Winstar Corp., the Court found the federal government liable for breach of what the plurality called a “risk-shifting agreement” between the Federal Home Loan Bank Board and three savings-and-loan thrifts. The agreement had allowed healthy S&Ls to use a favorable accounting device for valuing failing S&Ls as an inducement to the healthy S&Ls to acquire them. As the S&L crisis worsened, however, Congress reneged on the agreements by passing the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which imposed more stringent financial requirements on healthy S&Ls, eliminating the favorable accounting incentive. In a plurality opinion that opens a doctrinal Pandora’s box, the Court upheld the Federal Circuit’s decision that the government had breached its contracts with the S&Ls and was liable for damages.

226. See id. at 714-15.
227. See id.
228. See Hadfield, supra note 43, at 492-93 (arguing that in cases of government breach of “regulatory” contracts, government should be liable only for reliance rather than expectation damages).
230. See id. at 910.
231. Id. at 881.
232. See id. at 847-56. The device allowed favorable valuations for “supervisory goodwill” of the acquired S&Ls. Id. at 849.
234. See Winstar Corp., 518 U.S. at 856-57.
235. See id. at 910.
The matter of government breach has taken shape then largely in the shadow of the Contracts Clause, which forbids states from impairing private rights of contract. As with the demise of substantive due process in the wake of *Lochner v. New York*, the Contracts Clause’s potentially restrictive effects on government power subsided in the 1930s, as state governments began to successfully avail themselves of two affirmative defenses to actions for breach: the sovereign acts doctrine and the unmistakability defense. These are the two defenses that the plurality merged in *Winstar* and that commentators fear will amount to a net loss in government protection from suits for breach.

The unmistakability defense embodies the idea that:

> [w]ithout regard to its source, sovereign power, even when unexercised, is an enduring presence that governs all contracts subject to the sovereign’s jurisdiction, and will remain intact unless surrendered in unmistakable terms. Therefore, contractual arrangements, including those to which a sovereign itself is a party, “remain subject to subsequent legislation” by the sovereign.

In addition to unmistakability, the federal government has historically been able to afford itself of the sovereign acts doctrine as a defense to claims for breach. The doctrine has its roots in cases decided by the Court of Claims in 1865. Until *Winstar* the first and only application of the sovereign acts defense by the Supreme Court was in *Horowitz v. United States*. The plurality in *Winstar* rejected the unmistakability defense and all but merged the sovereign acts

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237. *See id.*

238. 198 U.S. 45 (1905). The death knell was sounded in *West Coast Hotel Co. v. Parish*, 300 U.S. 379, 392-93 (1937).

239. For a useful history of the origins of the two doctrines, and an explanation of the difference between them, see Graf, *supra* note 57, at 207-19.


243. *See id.* at 427.

and unmistakability defenses, arguably limiting their applicability in future cases.\textsuperscript{245}

\emph{Winstar} has breathed new life into arguments that the government ought to be vulnerable to breach of contract claims when it makes regulatory contracts on which it subsequently reneges. For some commentators, the case signals a shift away from judicial recognition of the government’s special sovereign status, and toward treating government as if it were any private contracting party.\textsuperscript{246}

Before \emph{Winstar}, it was safe to say that in cases alleging government breach of contract, courts granted considerable deference to both state and federal government defendants because of their sovereign status. Although there remain limitations on state governments’ freedom to breach their contracts for purely self-interested reasons, these limits are fairly minimal and are reserved for what seem like egregious cases of reneging.\textsuperscript{247} When states can satisfy courts that their breach is motivated by public-oriented reasons that fall within the legitimate exercise of their police power, they prevail. Now, ironically (in light of the fact that the Contracts Clause applies only to the states), state governments may well have more room to maneuver than the federal government. The post-\emph{Winstar} case law on suits against governments for breach could have an enormous impact on the future of regulatory contracting. In the wake of \emph{Winstar}, private parties may be encouraged to enter into contracts with government, but critics may grow more apprehensive about their antidemocratic potential.

In addition to this jurisprudence, local government law might conceivably be a source of guidance on how courts would treat regulatory contracts between government and private actors, because land use regulation is replete with public-private bargains. This jurisprudence is ad hoc, at best, however. The adjudication of government-private development agreements or contingent zoning cases consists of a morass of disparate decisions that, in the end, amount to context-specific judicial assessments of “reasonableness.”\textsuperscript{248} More promising are the attempts by scholars like Judith Wegner and Carol Rose to shape that jurisprudence with state and local governments’ dual and inseparable roles in mind and to develop standards by which to assess whether contractual regulation is inclusive, rational, and fair.\textsuperscript{249} This kind of approach may be a useful beginning point for reconceiv-

\begin{footnotesize}
\begin{itemize}
\item 246. \textit{See Gilliam, supra note 240, at 272}.
\item 247. \textit{See USA Group Loan Servs. v. Riley}, 82 F.3d 703, 714-15 (7th Cir. 1996).
\item 249. \textit{See id. at 328-43; see also Rose, supra note 179, at 882-903.}
\end{itemize}
\end{footnotesize}
ing the federal government’s dual roles as well, in the wake of Wins-
star.

VII. Conclusion

The rise of contract as an instrument of service and benefit provi-
sion and as an instrument of regulation will place great pressure on
contractual design and contractual remedies. It will challenge agen-
cies, courts, and legislatures alike to deal with new blends of regula-
tion and contract. Constructing a contractual regime to produce
meaningful accountability will require a significant attitudinal shift
on the part of agencies, which would need to play both the facilitative
role of contracting parties and the authoritative role of regulators.
Government agencies need to view contractual instruments as full-
brown accountability mechanisms designed to monitor quality, pro-
vide access to decisionmaking, and ensure procedural fairness, not
just as accounting tools for monitoring the award of huge sums of
money or occasional instances of discretion designed to provide relief
from rigid regulatory requirements.

For contracts to be meaningful accountability mechanisms, how-
ever, agencies must develop and adapt their monitoring capacity,
which requires both adequate funding and a shift in management
priorities. Agencies require sufficient resources to hire and train
personnel in contract management, but they must also shift their
contract management priorities from preventing fraud and waste to
overseeing quality and ensuring responsiveness to beneficiary com-
plaints. To accomplish this may require organizational changes, such
as centralizing authority for contract management in a single man-
ger or dividing contracts among a small group of coordinated man-
agers who answer to senior agency staff.

However, whether public-private contracts will ultimately under-
dine or enhance accountability will depend on more than just the
adaptability of government agencies. Agencies respond, after all, to
the incentives provided by Congress, the judiciary, and the Presi-
dent. Thus the fate of contract will depend significantly upon
whether legislators have the political will to demand agency over-
sight and whether they help to create the incentives necessary to
produce it. For example, if agency officials must account to congress-
ional committees only for fraud and abuse, they will continue to
marshal their resources to prevent it, ignoring the other substantive

250. See SARA ROSENBAUM ET AL., GEORGE WASHINGTON UNIV. MED. CTR., AN
EVALUATION OF CONTRACTS BETWEEN STATE MEDICAID AGENCIES AND MANAGED CARE
ORGANIZATIONS FOR THE PREVENTION AND TREATMENT OF MENTAL ILLNESS AND
SUBSTANCE ABUSE DISORDERS 21-22 (1997) (noting the need for Medicaid agencies to sup-
plement their internal analytic capabilities through agreements with other state agencies
and institutions specializing in data analysis).
features of their contracts with private providers. If Congress wishes to devolve and diffuse decisionmaking power, and to disarm agencies by shrinking their budgets, contract could indeed help to incapacitate the state. Even without drastic measures, Congress may frustrate the accountability-enhancing potential of contract by refusing to explicitly provide private rights of action in legislation or by failing to enable agencies to insert third-party beneficiary rights to sue in their contracts with private providers. By simply not recognizing the important role that agencies can play as “contractual partners” with private parties, Congress, the courts, and even the President may obstruct their effectiveness at every turn.

Courts will play a crucial role as well. They will need to elaborate upon the Supreme Court’s holding in *Winstar* and to wrestle with the doctrinal implications of the government’s potentially conflicting roles as sovereign and contracting party. The Supreme Court’s federalism jurisprudence could also have an indirect effect on the development of public-private contracts. Commentators have long noted a potential instability in the Supreme Court’s federalism jurisprudence: The Court’s antipathy for “coercive” federal regulation that interferes with state sovereignty seems incompatible with its simultaneous tolerance for stringently conditioned federal grants-in-aid.251 Conditional grants enable the federal government to regulate activities that are beyond its reach, because direct regulation would run afoul of the Tenth Amendment.252 Grants-in-aid have thus served as very important mechanisms for the federal government, allowing it to exert a powerful coercive effect on states, which in turn must supervise their contracts with private providers to ensure that they comply with federal requirements. Were the Court to curtail the federal spending power on state sovereignty grounds, it would cripple an enormously powerful contractual accountability mechanism.253

Thus, the courts’ role in shaping the contracting state will be considerable. The judiciary will determine whether the nondelegation doctrine forbids certain contractual delegations, delineate the extent to which private contractors will be bound by constitutional constraints and statutory due process obligations, and dictate the conditions under which third-party beneficiaries will have standing to

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253. *See Dole*, 483 U.S. at 211 (acknowledging that in cases involving conditions attached to federal funding, “the financial inducement offered by Congress might be so coercive as to pass the point at which ‘pressure turns into compulsion’” (quoting Charles C. Steward Mach. Co. v. Davis, 301 U.S. 548, 590 (1937))).
challenge the terms of public-private contracts. Taken together, the emerging jurisprudence in all of these areas will have an enormous impact on the future of contractual approaches to governance, even if courts do not explicitly see themselves engaged in the project now.

The dangers of contract as an administrative and regulatory instrument are undeniable. Contract could be a vehicle for legislative abdication of responsibility and fragmented accountability; it could badly weaken the state. From an administrative law perspective, public-private contracts may subvert important public law norms, such as public participation in decisionmaking, rationality, fairness, and accountability. However, in an era of inevitable public-private interdependence, contract also presents us with a potentially effective instrument of governance and a potentially powerful accountability mechanism. At a minimum, the rise of public-private contract will force legal scholars to confront the uncomfortable convergence of public law norms and private law contract principles, a project that holds great intellectual appeal and offers a promising agenda for future research.